UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

Final Diagnostic Assessment Report for Romania

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I. Overview

This report contains the preliminary findings of the second of four commercial law reform diagnostic assessments to be conducted under this project. The assessment was conducted in Romania between December 4 and December 18, 1998. The purpose of the assessment is to field test and refine a diagnostic methodology for measuring commercial law development in transition economies.

Romania's transition to a market economy has been protracted and painful. The legacy of the communist regime, extreme centralization, a high degree of bureaucracy, and no experience of partial reforms such as those undertaken in other Central European economies during the 1980s, left Romania with one of the longest paths toward a market economy.

The successive governments which ruled the country between December 1989 and November 1996 avoided serious economic reform, fearing socio-economic "shock" and its anticipated social costs, mainly the attendant mass layoffs. Although a reform agenda was developed and a large body of legislation enacted, little was done to actually implement reform.

Since 1990, Romania's policy has been to encourage foreign direct investment. To this end, a substantial body of legislation has been enacted to create a favorable investment climate. However, foreign investment in Romania has not kept pace with expectation. The new reform-minded government puts strong emphasis on the role of foreign capital, and has promised to remove the remaining structural barriers to foreign investment. Romania's private sector, which now represents 52 percent of the country's Gross Domestic Product (GDP), is growing rapidly and has become the chief engine of economic growth.

With 23 million people, Romania is the second most populous of the formerly centrally planned economies in Central and Eastern Europe. Romania's geographic position can also potentially lead it to be the one of the busiest transportation areas in Central and Southern Europe. The Romanian oil and gas industry is Eastern Europe's largest oil and gas producer. It also has the region's largest petrochemical industry. With 1.6 billion barrels of proven oil reserves, more than four times the total of other Eastern European countries combined, it has the most to gain from energy foreign investment. However, Romania's reform is one of the slowest in Eastern Europe.

Romania's ability to sustain economic reforms and promote a stable democracy faces some key constraints. The constraints, lack of access to a transparent and credible legal system, restrictions on property ownership, bureaucratic corruption and red-tape, to name a few, are similar to the constraints facing other countries in transition. U.S. assistance has been fundamental to some of the changes implemented. An assessment of Romania will provide an illustrative list of issues that must be addressed for an enforceable commercial law reform to be functional and sustainable.

In terms of legislative development Romania is the most unusual among the reforming economies of Central and Eastern Europe. The country has the largest body of pre-communist legislation,

which survived the communist takeover in the late 1940s. This long legal tradition proved to be a mixed blessing in some cases, because it encouraged the decision makers to preserve solutions which were clearly outdated and could not serve well the needs of a modern economy. On the other hand, the presence of the Commercial Code (adopted in 1887) in the body of applicable legislation provided the opportunity for the post-war generation to be acquainted with legislation completely forgotten in some other countries during the socialist period. No matter what the reason for the preservation of the Commercial Code, it fell into disuse in the years after 1945.

The Romanian legal tradition was based mostly on French models, because of the cultural similarities and the traditional adherence of the Romanian society to the Latin, rather then the Germanic school of legal thought. The Civil Code is modeled closely on the French Code Napoleon, and on the Italian Civil Code. It was adopted in Romania in 1864 and survived mostly intact until the revolution in 1989. It was not amended after World War II and the socialist concepts of property and predominance of administrative decisions over contractual obligations were never included in it. The legislative situation in Romanian contrasted strongly with the real life development - except for Albania, there was no other country in socialist Europe with such minimal opportunities for private entrepreneurial development as Romania.

Ironically, the Commercial Code was one of the first major laws which were amended and partly abolished after the revolution in 1989. It was partly replaced by the new Company Law[1] and partly by the bankruptcy legislation[2]. What remained of the Code are the basic commercial transactions, following the classic French tradition of the 19th century. But the significance of the Code for Romania is that it continues the tradition of separation between the Civil legislation (applicable for individuals and non - commercial transactions) and the Commercial law, which deals with business entities and business transactions exclusively, and is more adapted to the needs of the market. This may be the most important part of the Romanian legal tradition.

Recent legislative developments in Romania are directed towards the preparation of the country for EU membership, and the declared legislative priority is the harmonization of the legal system with that of the Union. This will give Romania the opportunity to restructure the legal system in a more organized and systematic manner and make it a useful instrument in the economic restructuring of the country.

As indicated by the table of general economic indicators and perception indices below, Romania has performed better than Ukraine and Kazakhstan on most indicators, but not quite so well as Poland. Economic growth is stagnant, and could be expected to fall after the Romanian Parliament reneged on its foreign investment incentives this past summer. This should also have a negative impact on the credibility index. Taken by themselves, Romania's indicators present a profile of an

[1] The Company law, Law #31 of 1991, as subsequently amended.

[2] Romania had several laws, dealing with bankruptcy and restructuring, the last being Law 64/1995 regarding the procedure of reorganization and judicial liquidation, published in the Romanian Official Gazette, Part I, no. 130, June 29, 1995, and amended by Emergency Ordinance 58/1997.

economy in transition, for which it is not yet possible to predict success or failure. Clearly, much work is left to be done.

Broad Indicator	*Poland*	*Romania*	*Ukraine*	*Kazakhstan*
Population (millions)[3]	*38.7*	*22.6*	*51.2*	*16.9*
Area (km2)	*312,683*	*237,500*	*603,700*	*2,717,300*
1997 GDP Per Capita[4]	*$6,400*	*$5,200*	*$3,170*	*$2,880*
Ave. D GDP (1990 – 1996)	*3.2%*	*0.0%*	*-13.6%*	*-10.5%*
% GDP - Government	*18.5*	*10.1*	*22.0*	*12.3*
% GDP - Industry	*30.7*	*38.7*	*40.1*	*30.4*
% GDP - Agriculture	*5.1*	*22.8*	*12.3*	*12.9*
% GDP - Services	*64.2*	*38.5*	*47.7*	*56.8*
Foreign Aid Per Capita	*$17*	*$9*	*$4*	*$8*
Corruption Index[5]	*4.6*	*3.0*	*2.8*	*--*
Credibility Index[6]	*68.05*	*52.96*	*>40*	*48.04*
Economic Freedom Index[7]	*2.95*	*3.30*	*3.80*	*4.05+*
EBRD Legal Transition Index[8]	*4/4*	*3/4*	*2/2*	*2/2*
Moody's Emerging Mkt. Rating	*Baa3*	*B3*	*B3*	*Ba3*

[3] Population Division and Statistics Division of the United Nations Secretariat, 1998 (http://www.un.org/Depts/unsd/social/poptn.htm).

[4] International Monetary Fund

[5] Transparency International 1998. Scale = 1 - 10. Higher scores indicate less corruption.

[6] Euromoney Magazine, December 1997. Scale = 1 - 100. Higher scores indicate greater credibility of government offerings and undertakings.

[7] 1999 Index of Economic Freedom Rankings, *The Heritage Foundation (*www.heritage.org). Scale: 1-1.99, free; 2-2.99, mostly free; 3-3.99, mostly not free; 4-5, repressed.

[8] European Bank for Reconstruction & Development, 1998 Transition Report. Scale = 1 - 4+, where 4+ is most advanced. 1997 and 1998 figures are included. Of those countries included in the Sample, only Romania's score changed between 1997 and 1998.

II. Summary Indicator Results

The summary table below contains the raw Tier I and Tier II indicator results. No attempt has been made to "balance" the four dimensions of this analysis, or give differential weighting to the subject matters areas. For a detailed discussion and analysis of the results, please consult the Tier III tables and associated narrative discussion for each subject matter area.

Based on the results of the in-country assessment, Romania ranks roughly equal with Kazakhstan, ahead of Ukraine, and behind Poland in most areas of legal reform. The overall level for legal framework is mediocre -- with two significant exceptions -- as is the level of implementation. The market for reform is generally quite low, so it is not surprising that there is a significant implementation/enforcement gap.

The one area of exceptional development is related to attracting foreigners. FDI and International Trade laws score 96% and 90%, respectively, suggesting a deliberate effort to attract foreigners. The effort, however, is superficial, for the rest of the investment environment is not highly conducive to investment, whether for foreign or local investors. Bankruptcy and collateral regimes are very poorly developed, and collateral implementation is marginal. Other areas score higher, but the statistical profile suggests that reform has been aimed at attracting foreign capital through incentives, in hopes, perhaps, that foreign investors would ignore the poor overall investment environment if the pot for their specific investments were sweet enough. With the collapse of that incentive scheme in July, no investment is being properly courted.

It may be useful to contrast Romania's foreign investment approach with Poland's. Romania has (or had, until July) an FDI law with very strong incentives. With a score of 96%, the law itself outpaced Poland by 9 points. The implementing and supporting institutions did not, however, measure up. The overall score for Romanian FDI was only 57%, compared to 77% for Poland. Indeed, for implementing and supporting institutions Poland's scores range from 66-82%, while Romania is far below at 38-58%. Poland has much higher foreign investment than Romania, suggesting that a few attractive laws are not nearly enough for development -- investors are looking for consistent laws, consistently implemented and supported.

Romania's very low market scores are also an area of concern. They reflect a lack of a sufficient supply of modern, market-oriented policy and legislation, as well as a lack of well reasoned demand. Much work will need to be done in developing a more informed understanding of the changes needed to support long-term economic growth.

The weakest scores are in the two areas that may have the most significant long-term impact on the availability of credit: bankruptcy and collateral. A well designed, well enforced bankruptcy regime permits lenders to assess and control their risks more effectively. Likewise, collateral law permits lower-risk, secured lending. Together, the two laws contribute to the growth and availability of lower cost credit for both business and consumers. The fact that both areas have very low scores in the market for reform suggests that there is a serious gap in understanding the function of these laws, or the benefits they can support. Romania must surmount the deficiencies

in these areas to move beyond self-financed investment and create an environment for broad-based development. Poland, which has much higher scores in both framework and implementation, also has much greater development.

	SUBSTANTIVE AREA	Poland	Romania	Ukraine	Kazakhstan
A.	**BANKRUPTCY**	**78%**	**54%**		
	1. Legal Framework	80%	59%		
	2. Implementing Institutions	80%	62%		
	3. Supporting Institutions	76%	52%		
	4. Market for Effective Bankruptcy System	78%	45%		
B.	**COLLATERAL**	**77%**	**32%**		
	1. Legal Framework	90%	44%		
	2. Implementing Institutions	79%	13%		
	3. Supporting Institutions	65%	35%		
	4. Market for A Modern Collateral System	75%	37%		
C.	**COMPANY**	**79%**	**62%**		
	1. Legal Framework	81%	63%		
	2. Implementing Institutions	76%	73%		
	3. Supporting Institutions	82%	70%		
	4. Market for Efficient Company Law	78%	43%		
D.	**COMPETITION**	**80%**	**60%**		
	1. Legal Framework	82%	66%		
	2. Implementing Institutions	81%	62%		
	3. Supporting Institutions	81%	62%		
	4. Market for Open, Competitive Economy	78%	49%		
E.	**CONTRACT**	**80%**	**63%**		
	1. Legal Framework	83%	74%		
	2. Implementing Institutions	83%	73%		
	3. Supporting Institutions	79%	66%		
	4. Market for Efficient Contract Law	75%	37%		
F.	**FDI**	**77%**	**57%**		
	1. Legal Framework	87%	96%		
	2. Implementing Institutions	82%	58%		
	3. Supporting Institutions	66%	38%		
	4. Market for Increased FDI	75%	37%		
G.	**TRADE**	**68%**	**54%**		
	1. Legal Framework	93%	90%		
	2. Implementing Institutions	71%	53%		
	3. Supporting Institutions	49%	40%		
	4. Market for Trade Liberalization	61%	35%		
AGGREGATE TOTALS for all areas of law		**77%**	**55%**		

III. Notes on Scope & Methodology

This diagnostic assessment was designed to help achieve the following objectives:

- To provide a factual basis for characterizing the degree of development and the level of effectiveness of the commercial law reforms initiated in Romania since the collapse of the Soviet Bloc in 1989 and adoption of a new constitution in 1991;

- To provide a methodologically consistent foundation for drawing cross-country comparisons in an effort to identify and describe the root causes of the "implementation/enforcement" gap; and,

- To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective C-LIR interventions in the region and elsewhere.

For the purposes of this effort, "commercial law" is defined to include the following substantive legal areas:

> Bankruptcy - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors.
>
> Collateral - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets.
>
> Companies - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
>
> Competition - Rules, policies and supporting institutions intended to help promote and protect open, fair and economically efficient competition in the market, and for the market.
>
> Contract - The legal regime and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.
>
> Foreign Direct Investment - The laws, procedures and institutions that regulate the treatment of foreign direct investment.
>
> Trade - The laws, procedures and institutions governing cross-border sale of goods and services

Each of these substantive areas has been assessed by collecting data across the four sample countries. Within each of these substantive areas, four "dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

- Framework Law(s) - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);

- Implementing Institution(s) - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);

- Supporting Institution(s) - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,

- "Market" For C-LIR - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

Within each substantive area, development indicators have been defined for each of the four "Dimensions" of C-LIR. The figure below provides a conceptual overview of how the development indicators are organized. The twenty-eight "cells" below represent groups of development indicators (or simple propositions) that are designed to provide a "snapshot" of the current state

of commercial law reform in each subject area. From a practical standpoint, the diagnostic assessment itself is performed by collecting and analyzing data through published sources, and face-to-face interviews, that are used to populate the development indicator tables.

IV. Interpretative Notes on C-LIR Indicator Tables

The Figures 1 and 2 below illustrate how the indicator tables are organized, and can be interpreted. The first example presented is a summary table of "Tier I" and Tier II" indicators for collateral law. The four "Dimensions" of commercial law development around which this analysis in organized appear in the left column of table. In this case, the table summarizes the collateral law. The next column to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the countries in this study will be compared. As indicated, the total score for Poland (185) and Romania (95) in the area of collateral law are to be compared against the reference value for this analysis (300). From this example, it might be inferred that Country A's collateral law system is more advanced than Country B's.

Conceptual Overview of C-LIR Development Indicators

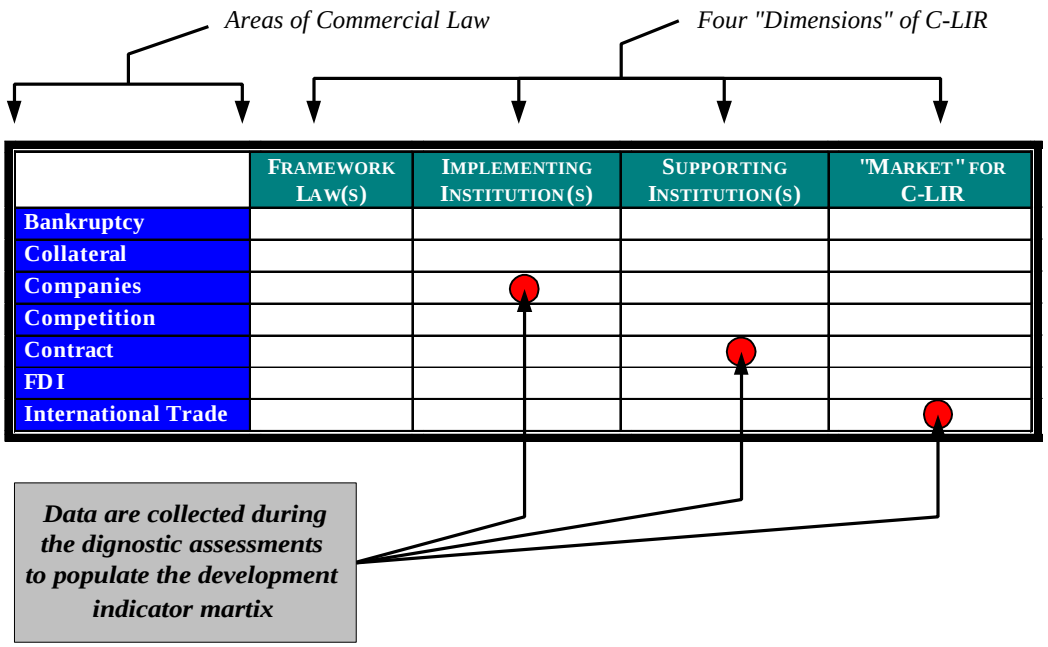

FIG. 1 - TIER I & II INDICATORS

COLLATERAL LAW	REF.	A	B	C	D
Legal Framework	100	85	90	22	64
Implementing Institution	100	72	25	33	47
Supporting Institution	100	34	67	35	49
"Market" for C-LIR	100	37	53	66	21
TOTAL	400	228	235	156	181

4 "Dimensions" of C-LIR

Country Totals = "Tier I" Indicators

Sub-Totals = "Tier II" Indicators

The Tier I and II indicators in Fig. 1 above, are derived from the raw data collected in the course of the diagnostic assessments. Tier I indicators provide the highest level of abstraction9 and are intended to be most useful to policy makers and those interested in broad regional comparisons of commercial law environments. Tier II indicators provide an intermediate level of detail, and are

FIG. 2 - TIER II & III INDICATORS

B.1.	LEGAL FRAMEWORK - COLLATERAL	REF.	A	B	C	D
1	Law recognizes personal guaranties, either direct or third party, and bank guaranties	10	2	1	3	7
2	Law recognizes non-possessory pledge in tangibles.	10	4	2	5	6
3	Law creates a property interest that allows holder to execute against the security.	10	4	2	5	8
4	Law allows flexibility in the type of security interest created, and nature of the interest secured.	10	10	2	2	4
	SUB-TOTAL	40	16	7	15	27

Tier III Indicator "B.1.3"

Indicator Identifier

Tier II Indicator

intended to be useful in program design and management where diagnosis and resource allocation are key concerns.

Tier III indicators provide the bedrock for this analysis. In Fig. 2 above, Tier III indicator values are assigned based on the findings of the diagnostic teams. The Tier III indicators are summed to yield the relevant Tier II indicator characterizing the legal framework for collateral law.

"Yet having begun, we must go forward to the rough places of the law...."

Plato's Republic, Book V.

As noted above, seven areas of substantive law are being considered in this study. The three tier approach outlined above, while admittedly complex, is intended to provide both the level of detail required by a specialist; yet the degree of abstraction required by senior program managers and policy makers as they address macro-level issues.

[9] Tier I indicators consist of the sum of twenty-eight Tier II indicator values (i.e., four "dimensions" each for 7 substantive areas of law under consideration) for each country analyzed.

V. Narrative Summary of Diagnostic Findings

A. Bankruptcy

1. Overview

The liberalization of state-controlled economies is a fundamentally messy process. State enterprises, who for decades produced what they were told to produce, find themselves suddenly faced with a bewildering state of affairs. Their inputs supply chain is disrupted, their market outlets disappear, and their products are typically viewed with indifference (or outright disdain) by consumers. Financial crisis, if not inherited from the former times, soon arrives with a thud.

The process of transition - while exceedingly complex - can be viewed narrowly (for the purposes of this Section) as a process by which new participants enter the market, and others exit it. In most cases, a reformist government need only stabilize the macroeconomic environment and eliminate state controls in order to spark a flood of new entrants. The more difficult process to manage, understandably, is how under- and non-performing enterprises *exit* the market. Properly done, a well designed bankruptcy system provides an efficient market clearing mechanism that helps assure orderly market exit and equitable liquidation of insolvent debtors obligations.

Bankruptcy legislation is for this reason one of the more contentious areas of legal reform for transition economies. Reform implies a tradeoff between short-term economic dislocation (e.g., increased unemployment, decreased micro-economic activity, etc.) and long term economic growth - the tangible benefits of which will be felt long after the next election cycle. It is not surprising, therefore, that political pragmatism frequently wins out over visionary leadership in this area of commercial law reform.

In addition to providing a mechanism to mediate conflict between and among debtors and creditors, bankruptcy laws also provide an economically and socially beneficial systems of triage for worrying - but not necessarily terminal - cases of financial dyspepsia. Thus, bankruptcy is distinguished from collateral and secured transactions law, both of which address an individual creditor's interest in property and collection remedies relating to that property. The two sets of law converge in the area of priorities, where multiple, conflicting claims may be made on the same assets.

There are several different approaches to bankruptcy that have emerged from the CEE/NIS region. These range from "straight" bankruptcy on one extreme, to insolvency proceedings geared toward rehabilitation at the other. These models also vary in the type of debtors covered. The alternative models encompass individuals and registered for profit entities. These models include a disaggregation
of the classification of covered enterprises – e.g., agricultural, financial and nonprofit entities - that may be excluded from bankruptcy. Other key differences include:

- Who may initiate a bankruptcy proceeding; and,

- How large an estate needs to be prior to allowing the creditor and/or debtor access to the bankruptcy code.

There is also considerable variation in terms of the substantive prerequisites for bankruptcy proceedings. Variations here may include the following:

- Cessation of payments;
- Inability to cover current indebtedness with current assets;
- Inability to pay all debts taking into account all prospective liabilities;
- General nonpayment of maturing debts that are not covered by legitimate disputes;
- Inability to pay on a regular basis ones' liabilities, and,
- Undertaking certain acts that clearly signal insolvency.

Among the many issues examined in these diagnostics of the current state of the region's bankruptcy law and institutions are exempt versus non-exempt assets; title to property in bankruptcy proceedings; preferences; and creditor priorities.

2. Diagnostic Findings

Legal Framework
Romania's Commercial Code of 1887 was the basis for the country's pre-communist bankruptcy procedures. Because it was never formally abrogated, the Commercial Code of 1887 became the basis for dealing with bankruptcy in the early post-communist years (1989 to 1995). The Code empowered judges to administer all bankruptcies (liquidations as well as restructurings initiated by debtors and approved by 75% of the creditors). The court also was empowered to initiate cases on its own.

The 1887 Code provided for direct judicial administration of the bankruptcy process and this tradition was carried over to the first major bankruptcy legislation (Law 64/1995). This provision was problematic as it prevented the emergence of a specialized profession of receivers and burdened the judges with obligations which were not related to their principle field of expertise. Instead of being involved in dispute resolution, the judges were in fact put in charge of an enterprise and were required to manage the day-to-day affairs of the business. The remuneration of the *syndic* judge was in no way related to the size and complexity of the case and this reduced the incentives for speedy and efficient resolution of bankruptcy cases.

Since 1989, Romania has promulgated bankruptcy laws that are favorable to the development of a market economy. Principal legislation includes Law 64/1995, Emergency Ordinance 58/1997 that modifies Law 64, and the Law on Bankruptcy Procedure for Banks, Law 129/1998. This legislation provides the basic structure for debtors and creditors to both liquidate and restructure enterprises as well as to establish some creditor priorities. Since 1995, approximately 6,000 bankruptcy cases have been filed. The passage and the implementation measures taken in support of this legislation reflects the commitment of the Government of Romania, led by the Ministry of Justice, to undertaking this reform.

Romania's bankruptcy legislation needs to be amended in order to facilitate economic development and make this market more attractive to local and overseas investors. Amendment requires resolving conflicts between existing laws (e.g., Law 64 required only a 50% affirmative vote; Emergency Ordinance 58, which was not ratified by the Parliament at the time of this assessment, changed this to 75%.); introducing new legislation that will facilitate the administration of the bankruptcy process and the development of professionals specializing in relevant support services; and assuring the timely and effective implementation of the corrected legislation.

Some of the systemic problems identified in the diagnostic are summarized in the table below:

Excessive Judicial Burden	▪ Current legislation requires judges to undertake non-judicial managerial roles in the bankruptcy process, similar to that assumed by a trustee in bankruptcy. Judges are overburdened by responsibilities including: - Taking inventory - Handling the receipt of all moneys - Due diligence of the debtor - Converting assets to cash - Managing the debtor's business - Investigating the bankruptcy causes
Judicial Training	▪ The Minister of Justice has determined that a judge must be trained in the fundamentals of bankruptcy law and procedures prior to becoming a *syndic* judge. However, *syndic* judges continue to handle non-bankruptcy cases. This lack of specialization reduces the effectiveness of this training initiative.
Judicial Empowerment Issues	▪ *Syndic* judges are limited in their ability to appoint qualified administrative receivers because creditors holding 75% of the outstanding debt must affirmatively vote by a 50% margin for the appointment of an administrator.
Funding Limitations	▪ Judges do not have adequate funding to engage qualified administrative receivers. ▪ *Syndic* judges have the same status as ordinary litigants in filings involving abrogation of fraudulent conveyances and property recovery. They are required to pay a filing fee (stamp tax) and frequently do not have the funds to further prosecute the matter. ▪ Funding limitations also hamper other administration initiatives.
Lack of Qualified Administrators	▪ Insufficient government remuneration discourages qualified administrators. ▪ Since more money can be made in the private sector, there is little incentive to participate in specialized administrator training.

Judicial Review Issues	▪ Challenges to *syndic* judges actions are brought before a tribunal in which the *syndic* judge sits with his or her fellow judges rather than in a *separate* appellate court. There is a strong likelihood that fellow judges will vote in favor of the *syndic* judge's decision.
Petty Petitions	▪ Low fees (currently 100,000 lei or U.S. $10) encourage the use of the bankruptcy system as an alternative debt collection mechanism. Ordinary commercial claims require the payment of 10% of the amount in dispute (stamp tax).
Lack of Sanctions	▪ *Syndic* judges have no effective system of sanctions that can be used to compel debtors to provide required information.
Lack of Procedures	▪ There is no "code of procedures" dealing with bankruptcy and little printed guidance on exceptions to the rule.
Standing	▪ Under Emergency Ordinance 58, only liquidators have standing to start recovery actions.
Priorities	▪ Secured creditor priorities vis-à-vis other creditors are unclear under Emergency Ordinance 58. Government claims appear to have priority over other claims, and debts arising during reorganization are not given priority. This is problematic because of the need for additional financing to cover the working capital needs of the business. ▪ Creditors need to know that their respective priority positions will be maintained, something undermined by the Emergency Ordinance 58 reference to Ordinance 11.

While the Romanian bankruptcy system does provide limited exit mechanisms for creditors, it is critically flawed in several respects. In addition to the legislative deficiencies described above, Romania lacks an effective and complementary collateral/secured transactions law. Further, the country does not have an official central registry where all bankruptcy filings may be recorded.

One flaw in the Romanian bankruptcy system is the lack of a complementary secured transactions code. Romania needs a single integrated (accommodated) body of law that establishes clear creditor rights based on secured interests and priorities and that brings together consistent rules for adjudicating bankrupt estates. Since market economies are credit dependent, there must be a system of rules that allows creditors adequately to control risk so that they are willing to lend money. Yet, in the course of this assessment, it was clear that Romanian financial institutions such as commercial banks are barely participating in commercial or consumer lending. Instead, their lending focuses principally on government treasury purchase and trading. The banks' reluctance to provide commercial, market economy type loans is the result of a legal system that does not provide an adequate foundation for hedging against the risk of an otherwise unsecured loan.

A basic secured transactions system would bring together the following:

- Concise definitions of security devices (e.g., warehouse receipts, chattel mortgages, accounts receivable financing, etc.)
- Creditor rights and priorities
- Debtor defenses
- Creditor filing requirements
- Registry requirements
- Reporting requirements
- Precise priority rights in bankruptcy proceedings vis-à-vis other creditors and government bodies
- Concise definitions of voidable interests (interests that do not meet established standards and therefore do not qualify for priority preferences)
- Bankruptcy adjudication standards

Implementing Institutions

Bankruptcy Law 64/1995 does not represent an improvement over the 1887 Code with respect to the administration of the bankruptcy process. The current law places excessive responsibilities on the *syndic* judge and restricts the ability of the court quickly to appoint specialized professionals who are capable and motivated to complete the process in a timely manner. There are 129 *syndic* judges in Romania who are typically commercial law tribunal specialists specifically appointed to handle bankruptcy cases. While they have no special qualifications to carry on this work, all of these judges have received some initial training on bankruptcy. To date, training has not been broadened to cover business management and administration.

Some specialized training has also been undertaken to facilitate the development of a pool of support specialists, including 30 liquidation specialists; 23 court clerks; and 54 receivers. Nevertheless, inadequate budgets limit remuneration rates which in turn reduces the pool of available individuals with specialist training.

While only *syndic* judges oversee bankruptcy cases, these judges continue to have other case responsibilities outside the bankruptcy area. Appointment to a large bankruptcy case that may go on for several years could represent a major time burden for *syndic* judges. Further, there are no special incentives for this additional work.

As noted in the above table identifying systemic problems, *syndic* judges may appoint an administrative receiver; however, an appointment must be approved by a high proportion of all creditors to that end (75% of the debtors as a quorum and 50% of the vote of this group of creditors). Such an additional step is extremely burdensome. Emergency Ordinance 58 fails to recognize the difficulties in gathering a large body of creditors, especially in cases with a large number of small claimants. Nor does this Ordinance does provide for compulsory formation of creditors committees in some cases, as specified in the preceding Law, or for other mechanisms prompting less interested creditors to participate in the process.

The procedures under the Commercial Code clearly gave absolute propriety to secured creditors, effectively excluding the pledged property from the bankruptcy estate. Article 104 of the current

law as amended by Emergency Ordinance 58 confirms this arrangement and preserves the rights of secured creditors but priorities remain a problem. For example, it remains to be verified how the provisions related to government budgetary claims affect the rights of secured creditors. Ordinance 58 refers to another law on public finances (Law 72/1996) and Ordinance 11/1996 as amended by Law 108/1996. Such practice allows the government to substitute the existing emergency ordinance with another one that in fact will take precedence over the provisions of Ordinance 58 with respect to the priority awarded to the budgetary claims.

The priority awarded to bank claims is somewhat unclear and seems to give disproportionate advantage to the banking sector over all other non-secured creditors. As a policy, this provision may be justified because of the importance of preserving the stability of the banking system but as practice it may eliminate the non-banking institutions as potential lenders.

By virtue of the nature of the bankruptcy procedures in Romania, there is no state institution except the courts that administer the process. The courts clearly lack the necessary capacity because of the large number of cases, inadequate training, and the initial policy on which the system is based. An estimated 6,000 cases have been filed since Law 64/1995 was promulgated. While the number of new petitions decreased between 1996 and 1997 by approximately 8%, the number of outstanding cases increased by 93% over 1996. As noted above, current legislation does not facilitate access to qualified support staff and professionals.

Current legislation requires parties to exercise a degree of sophistication that is simply not available within the existing pool of *syndic* judges, lawyers, accountants, administrators, liquidators, and restructuring consultants. Further, the passage of Emergency Ordinance 58 directly contradicts provisions of the initial enabling legislation, Law 64. Ordinance 58 is considered counterproductive by almost 80% of the *Syndic* judges and it has yet to be ratified by the Parliament. This creates great uncertainty for judges and attorneys handling bankruptcy cases.

The process of legislative drafting in Romania clouds prospects for positive legislative change. (See, Section I below). Drafting of commercial laws should be entrusted to practitioners who will undertake a process that assures dialogue with all affected interest groups. Further, drafting should be staged and the process laid out or structured so that there is relative transparency. Ultimately, the proposed laws should be acceptable to the institutions that will be administering them. For example, in discussions with the Bank of Romania, it is noted that legislation is being passed without vetting by the very institution that oversees banks and part of the bankruptcy processes. The government agency with oversight is then put in the position to establish regulations covering laws that may not be effective.

Supporting Institutions

Another flaw in Romania's bankruptcy system is the absence of an officially sanctioned Romanian Registry that would record bankruptcy filings, and there is little or no basis for secured transaction filings at such a depository. This is problematic since a collateral and bankruptcy registry is a fundamental institution and necessary adjunct in a successful market economy. It serves as a secure database holding all official records related to collateral transactions and bankruptcy. Its

transaction recordation serves as a filter that can be used to filter out spurious claims, establish interests, and determine priorities. It typically may also hold complementary information that is germane to commercial transactions. Further, it is typically designed to be easily accessible for creditors, debtors and other interested third parties.

While a bankruptcy and collateral Registry is not officially sanctioned, Romania has a *national* registry that is positioning itself to assume this depository role once adequate legislation is in place. This is the Company registry currently operated by the Chamber of Commerce and Industry. Further, if enough Romanian private lending institutions recognize the opportunities for greater profitability that may result from making traditional commercial loans, these lending institutions' collateral needs may become the driving force for this Registry to start recording commercial transactions involving secured interests. Other East European states have successfully initiated collateral registries in advance of the foundation legislation. For example, in the case of Latvia, a sophisticated collateral registry was created and has operated successfully because of demand from commercial lending institutions and leasing companies. Arguably, the existence of this registry served as a major stimulus for the Parliament's eventual passage of legislation.

B. Collateral

1. Overview

Collateral law is intended to facilitate commerce by standardizing transactions and fostering predictability and simplicity in them. More specifically, secured transactions are intended to structure the dealings of debtor and creditor so as to preserve the rights of some creditors against the rights of others. Standardization is intended to assure familiarity and thus encourage commercial transactions.

The ability to use security interests in movable property to support the extension of credit is essential for a market economy. Commerce and industry need inexpensive capital to thrive, and lending that is secured by a pledge represents one of the most economical means of procuring financing because it significantly *reduces* the creditor's risk. Secured lending goes beyond the borrower's contractual agreement to repay since it provides a second source of payment. In fact, a legal system that assures the lender that it can maintain a secured interest is just as essential as a system of contract law.

2. Diagnostic Findings

Legal Framework
Collateral interests are currently covered by the Romanian Commercial Code. Under the Code, collateral is based principally on a possessory lien: the creditor holds the collateral for the term of the loan. Two exceptions exist under Article 480 of the Commercial Code: 1) harvest on the root that can be pledged; and, (2) processed goods.

Most jurisdictions in Europe prior to World War II had similar provisions. Prompted by the needs of a market economy, the legal community managed to find creative solutions to circumvent these restrictions and, recently, to create new legislation governing collateral. Romanian lawyers are no exception and some of the European practices are common in Romania as well.

The execution title procedure appears to have been used in one recent bankruptcy case in Romania. The respondent, the principal creditor in this case, feared that "unsecured" assets would be squandered and lost before the syndic judge acted to preserve the estate. The creditor presented the "execution title" to the local police who used it as a pretext for immediately seizing assets from the bankrupt

Because such arrangements were not necessary in Romania—a socialist economy—they gradually fell into disuse and were discontinued. Yet the need for a detailed regulation covering non-possessory pledges was not foreign to Romanian lawyers immediately after World War II. Thus, in 1945, a special credit institution—the National Company for Industrial Credit (NCIC)—was established with the purpose of providing targeted credit for industrial development. At this time, the Romanian economy was still mostly private and the institution was

designed as a vehicle for furnishing credit for productive purposes. A progressive collateral law was enacted on 12 February 1945, authorizing a system of regional collateral registries for non-possessory pledges (Article 31). Indeed, such registries were limited to the credits provided by the NCIC and to goods used in the production process (equipment was not covered). Following the nationalization of industry in the late 1940s, the law was abolished and the NCIC dissolved in September 1948.

Currently, Romania has no effective collateral law system and the non-possessory pledge is not regulated by any current legislation. In fact, the non-possessory pledge is prohibited by Article 480 of the Commercial Code. Some major local and foreign commercial banks and lending institutions are advocating the creation of a non-possessory collateral law including a registry. Such legislation and a registry would increase banks' willingness to make loans and reduce the cost of loan administration.

Some local banks, however, are satisfied with the present collateral situation. Most of their revenue is derived from trading in the money market and not in making loans. When loans are made, a banking institution frequently utilizes a system of "warrants" to protect its pecuniary interests. The system works in the following way:

1) the title to the property is delivered by the debtor to the lender while the property effectively remains in the possession of the debtor,
2) the title is released only upon full repayment of the debt, and
3) the underlying contract may be registered in a court filing.

Registration expedites the procedure for obtaining an "execution title" from the court if this becomes necessary.

The problems with this system include the following: first, the status of the pledged property is not clear because there is no way of being assured that there are not other non-possessory interests in the property. Second, there is no central repository of information on the property. Third, the administration process is cumbersome and expensive. Fourth, it is not clear how the pledged property is reflected in the debtor's financial statements and therefore there is no real way to value the enterprise's property. Fifth, while the system is being used for large capital equipment, it is not effective at dealing with smaller equipment of other types of financial instruments that can be pledged (e.g., factoring).

As noted above, some banks reported no interest in changing the current collateral system because they deal with risk in alternative ways. In some instances they look to the cash-flow of the borrower, its overall financials, the revenue stream directly driven by the newly acquired equipment, and the personal relationship with the potential debtor. Further, some reported requiring the borrower to take out insurance on the capital equipment and naming the bank as the beneficiary in the event of repayment default. Such insurance is provided by specialized insurers and also covers defaults by individual borrowers who have also purchased consumer goods on credit.

The insurance scheme does not represent a viable solution to the collateral problem. It merely transfers the risk to a third party and increases the overall cost of borrowing. The insurer is then placed in the same position as a bank—at risk without knowing about secondary liens on the property.

Romania is quite far behind other CEE countries that have passed collateral laws. Clearly, Romania can benefit from a system of collateral legislation similar to those established in Bulgaria, Latvia, and Poland. Security interests in movable property would support the extension of commercial and consumer credit, both of which are essential for a market economy. Interestingly, while many CEE countries have developed a non-possessory pledge system, many have failed to carry this to the next logical step—creating a centralized registry to record secured interests. Romania has a sophisticated registry system developed to handle company registration and more recently adapted to record bankruptcies. This registry system would be an ideal complement to a Romania collateral system.

A Ministry of Justice source reported that a draft Collateral law has been prepared by a group of young Romanian attorneys but has not yet been reviewed by the Ministry. Other draft legislation being considered is based on the Model Secured Transaction Code established by the EBRD and the Collateral Law for Moveable Property that is being championed by Center for the Economic Analysis of Law (CEAL).

While some private and government attorneys believe that a collateral law is needed, those interviewed stated that there are no strong advocates for this change within the Government of Romania and that there have been no policy discussions regarding the benefits from having such law in place. Evidence that such legislation can be perfectly compatible with the Continental legal tradition is either not known or largely ignored by the competent authorities in Romania.

Despite a lack of positive movement within the government, there is reason to be sanguine about the prospects for such legal reform. First, commercial banks clearly will benefit from this initiative, as will leading members of the Chamber of Commerce and Industry. They recognize that the existence of a well-functioning market economy requires an enforceable legal system that includes property rights with a complementary systematised collateral system and registry. Such a system leads to macroeconomic stability and enhances the performance of a market economy. It is an essential building block for establishing a well-developed financial sector because it makes risk more manageable. Secondly, accession to the EU will require such an initiative. Finally, Romania is ideally positioned to initiate an effective collateral registry system. It currently has an operational company registration system that is computerized with regional wide area network (WAN) access and is national in its database coverage. This system could be expanded to cover collateral registration for business purposes. It is already being used to track enterprise bankruptcy filings, a development that has taken place without legislative authorization, or government or donor support. Incorporating a collateral registry system with this database registry will improve the ability of lending institutions to provide credit for productive purposes.

Implementing and Supporting Institutions

Romania has *neither* a central registry that records secured transaction filings nor an effective collateral law. The combination of a self-sustaining registry and appropriate legislation assure predictable and consistent results in commercial transactions involving security interests. This is essential to the creation of a sustainable market economy, instills both domestic and international confidence in the country's financial system and fosters private sector development by increasing the ability of reasonably priced credit. Although a legal and regulatory framework for collateral filings has not been established, there are a number of Romanian institutions that may be expected to support the implementation of both a registry and promote appropriate legislation.

A lead institution in this initiative is the Chamber of Commerce and Industry. The Chamber's management recognizes the importance of a nationwide data base that services businesses and that will be a building block in developing the market economy. In addition to its vision, it has shown its technical competence by designing and implementing a successful company registry that is accessible by subscription over the internet. This data base has now been expanded to post bankruptcy filings, an initiative that has neither been officially sanctioned nor supported by the government. The Chamber's management recognizes the importance of a collateral registry and is prepared to use its existing platform for this purpose pending the availability of filing data. In addition, the Chamber may be expected to be able to play a catalyst role in educating business and finance leaders, government officials and Parliamentarians about the importance of a secured transaction system.

Legislative initiatives should focus on 6 basic areas of secured financing:

1) an automatic extension of the security interest from the original collateral to property acquired by the debtor after the creation of the security agreement (e.g., inventory financing);
2) the automatic encumbrance of proceeds;
3) the need for a purchase money security interest—allowing a debtor to gain credit despite an encumbrance on the entirety of current assets;
4) the protection of ordinary course buyers;
5) the need for a fast and inexpensive enforcement system; and,
6) the need for proper notice of encumbered assets—the basis for creating a collateral registry.

There are a number of Romanian institutions that may be expected to support such a legislative initiative. These programs may include the following: the creation of *ad hoc* task forces or advisory committees to study the market economy related multiplier effect of a comprehensive collateral law; the development of education and training programs; the development of surveys; and, the creation of lobbying groups.

Among the institutions that are likely to be important to this initiative are the following:

Organization	Participation
Chamber of Commerce and Industry	• Task force • National Educational Programs • Surveys • Legislative Drafting Committee
Romanian American Chamber of Commerce	• Task Force • Surveys • Lobbying
National Council of Small & Medium-Sized Enterprises	• Members Educational Programs • Surveys • Lobbying
American Chamber of Commerce/Romania	• Surveys • Local Educational Programs
Young Lawyers Association (various)	• Educational Programs • Legislative Drafting • Training in secured transactions • Law School Initiatives • Lobbying
Law Schools	• Education programs • Design of interim collateral lending strategies within confines of existing law

Preparatory to a comprehensive secured transaction law being drafted and enacted, it behooves the law schools, lawyers' associations, financial institutions, etc., to facilitate the development of collateral lending techniques beyond possessors' interests. This may be accomplished by designing collateral programs that utilize existing legislation in creative ways. There is necessary complexity in this process and enforcement may be compromised because of limited judiciary training. Nevertheless, the creation of secured transactions will require the use of a registry and may play a catalyst role leading to the creation of a fully rationalized system. Further, enforcement may be facilitated by a Ministry of Justice initiative that extends the scope of Syndic judges into the allied field of secured transactions. Much of the Syndic judges' training is topically related in such areas as priorities. The enactment of a comprehensive collateral law will have a direct impact on existing Romanian bankruptcy law.

C. Company

1. Overview

It is well established that for-profit enterprise development (e.g., partnerships, corporations, sole proprietorships, etc.) cannot flourish in previously non-free-market economies without active governance that assures domestic and foreign investors that there is regularity, predictability, and transparency in all commercial undertakings. In the CEE/NIS, this is a critical period of private institution building that requires the dedication of internal and external financial resources to fund a process of enterprise privatization, restructuring, turn-around, revitalizing, renewal, and new business development (e.g., venture capital type start-up businesses). The government in each of the CEE/NIS countries represents part of the critical support system, which also includes NGOs.

Government regulation is essential, therefore, in terms of encouraging and facilitating the development of these enterprises, establishing standards for the internal governing of these institutions, and controlling their role in the overall economy because of potential abuses in their freedom of contract. This regulation may be part of the existing civil code, a new system of commercial codification designed to establish standards of practice in specifically defined situations ranging from commercial and secured transactions, bankruptcy, taxation, or the result of court-developed concepts such as fiduciary duty and the application of contract law. Constructive governance in this context also requires both an operating ethic that is conducive to for-profit enterprise development and that is broadly accepted by all political and bureaucratic levels. This is demonstrated by factors that go beyond code promulgation and to the very heart of the operations of the systems that result from the earlier stages of legal and regulatory reform. Examples include, among many others, increasing the size of the judiciary; educating judges about both code and regulatory reform and its importance to the overall performance of the economy; providing reasonable remuneration for the judiciary; the creation of registry bureaus that assure accurate recordation; assuring enforcement by getting buy-in by all key participants at the political, bureaucratic and business level; etc.

Company law plays a key role in market economies as it establishes guidelines for the internal organization of private companies and for corporate governance. Along with securities legislation, company law tries to protect outside investors and the public by specifying minimum requirements for capital and for the publication of information about the company. It also aims to encourage entrepreneurship by setting limits on the liability of investors.

2. Diagnostic Findings

Legal Framework
With few exceptions, transition economies have liberalized the legal regime for business organizations and provided a basic framework for different types of organizations. In Romania there are no specific investment approvals required to establish a business. In addition, there has been much recent improvement in the choice and introduction of corporate forms. By continental

standards, start-up formalities for new companies in Romania are quite expeditious. However, the protection of shareholder rights and corporate governance are more problematical.

Before the Communist takeover, Romania had a traditional continental company law, which was abrogated during the Communist era. In the first year following the 1989 revolution that displaced the Communists, the earlier traditional system was basically restored. In November 1990, the ***Companies Law*** (Law No. 31 of 1990) re-established the principal types of company organization typical of continental legal systems. These include the ***general partnership***, the ***limited partnership***, the ***limited partnership by shares***, the ***limited liability company***, and the ***joint stock company***. The latter two are the most common types of business organization in Romania.

The Romanian ***joint stock company*** resembles the French SA, the German AG, and the Anglo-American public corporation. Extensive information and procedural requirements are imposed on this form of company in order to protect large numbers of anonymous investors. The joint stock company is an important company form in all mature market economies. It was hardly used in Romania after 1989, but its use is currently increasing.

Under Romanian law, at least 5 shareholders are necessary to establish a joint stock company. They can be residents or non-residents, and legal or natural persons. The minimum prescribed capital is Lei 25 million (approximately U.S. $2,500). Paid-up capital must be at least 30% of subscribed capital (100% for contributions in kind). The capital is divided in freely transferable shares and the company may issue debentures up to a debt-equity ratio of 75%. Registered capital cannot be increased before all shares previously issued are paid in full. A prospectus is required if stock is to be offered for public sale. The Contract and the Statutes (the bylaws) for establishing the company must be approved at the first general meeting of shareholders.

With regard to ***corporate governance***, Romania's Company Law provides for a sole administrator or a board of administration to be chosen by the general meeting of shareholders. The board may delegate some of its powers to a managing committee. The president of the board of administration is required also to be the director of the managing committee.

The Romanian ***limited liability company*** follows the form used throughout continental Europe of the French SARL and the German GmbH. It combines some of the benefits of the joint stock company with the relatively simpler procedural requirements of the general partnership, and is particularly well-suited to small and medium-sized firms with only a few owners. This is by far the most common form of company in Romania.

Limited liability companies may have between one and 50 shareholders and minimum capital of Lei 2 million (approximately U.S. $200). The companies are prohibited from issuing debentures, and shares are transferable outside the company only with the agreement of shareholders holding 75 percent of capital. Because of the more personal nature of the expected relationship among owners, no prospectus is required to set up the company. All associates must have access to the books of the company at any time, and they may perform the duties of auditors if no auditors are

appointed at the General Meeting. Although most decisions at the General Meeting require only an absolute majority of the associates and of the registered shares, unanimity is required to alter the company contract or statute. A one share-one vote rule is mandated (Article 141), in contrast to the more flexible voting rules of the joint stock company.

With regard to corporate governance, a limited liability company is to be managed by one or more administrators appointed by the company contract or by the general meeting of associates. A board of directors is not required.

In the ***general partnership***, all partners have unlimited joint and several liability with regard to the partnership's obligations, and all are entitled to participate in the management of the business, unless provided otherwise in the partnership's contract. This form is most suitable for small enterprises with a few active participants.

In the sleeping partnership (***limited partnership***), in contrast, only the active partners (who serve as administrators) have unlimited liability, while the liability of the sleeping partners is limited to their capital contribution. This form is more suitable for larger undertakings where a few active participants are seeking capital from passive investors.

The ***partnership limited by shares*** or ***joint stock company limited by shares*** most closely resembles the joint stock company in its formal requirements, including minimum capital, prospectus requirements, founding and general meeting requirements, procedures for valuation of in-kind capital, auditing requirements, and record keeping. Because of this formality, this form is unlikely to be used much in practice in Romania.

Shareholder Rights - Business organizations irrespective of their size or legal form are set up by mutual agreement of the founding parties and new participants join on an equal voluntary basis. However, legislators in most countries have provided a set of mandatory provisions for certain companies, especially joint stock companies. In the case of joint stock companies the assumption is that investors require more legislative protection because the often large number of shareholders makes it difficult for them to organize as a group, and thus could be easily outmaneuvered by the company's top management. Romania (and many other transition economies) requires companies with more than 50 shareholders to be organized as a joint stock company in order to be subject to the more stringent requirements of that legal form.

Shareholder rights are commonly defined as the right (i) to participate in a company's affairs through attendance at shareholder meetings and voting rights and (ii) to participate in profits in the form of dividend payments and claims upon liquidation of the company. Yet in transition economies company laws fail to provide shareholders with the means to enforce these rights. This is particularly true with respect to former state companies that have been privatized. The new shareholders are at considerable disadvantage vis-à-vis management, and are often locked into their holdings as capital markets remain undeveloped. In spite of this, they have little scope for "voice" in the company. Romanian law does not specifically regulate shareholder derivative suits. It remains to be seen whether such an action would be tenable in the current environment in which

there is no clear legislation creating shareholder rights and there is no body of judicial decisions dealing with this issue.

Even though company laws establish the "one share/one vote" principle, it may be restricted. Romania's company law provides that a company's certificate of incorporation may restrict voting rights by stipulating the highest number of votes or highest number of shares a shareholder may vote on, irrespective of the shareholder's total holdings. These provisions prevent large shareholders from making full use of their property rights, such as in recently privatized companies where management has retained de facto control over company decision-making and the new owners have no way to make their influence felt.

Corporate Governance - Corporate governance is a critical issue not only in Romania but also in all CEE countries. Many variables in an economy—including the dispersion of share ownership, the type of owner, and the tightness of other market-based constraints on managers—have an effect on corporate governance. Company laws are also important, because they provide the framework in which owners actually exert their influence in monitoring managerial behavior.

Looking at the Romanian Company Law, there is one obvious concern. In the case of joint stock companies, the president of the board of administration is required also to be the director of the managing committee. This requirement is problematic because it focuses so much power (essentially the roles of Board Chairman and CEO) in one person. This focus of power may be reasonable in some cases, but there is the obvious risk of abuse of power.

In order to give shareholders effective control rights, Western company laws often stipulate general standards of business conduct for top managers and provide detailed guidelines for transactions that involve potential conflict of interests. Defining and enforcing standards for business conduct on the part of top managers has proven particularly difficult in the economic environment of transition countries. Absent a developed business culture and faced with economic instability, most transition economies have been cautious in trying to define such standards. Perhaps more important than defining a positive standard for directors' conduct appears to be a clear definition of negative standards accompanied with an effective enforcement procedure. One cannot say that Romania is very far advanced in this area.

Relationship with Securities Legislation - These two areas of shareholder rights and corporate governance are of particular importance for public companies that are raising capital on the emerging capital market. In Romania it seems that these two areas are mostly dealt with in the framework of the securities laws, rather then being incorporated in the company legislation.

This approach may cause confusion in the law by introducing the so-called "closed" joint stock company, which in form overlaps with the limited liability company already in existence. Apparently no policy discussion took place when the decision was taken to introduce the "closed" joint stock company.

The disadvantage of this arrangement is that many general provisions of the Company Law may need to be repeated in the parallel legislation, or risk being considered not applicable to the new company form. This may be a source of legislative confusion. Most important, judging by the U.S. experience, a body of judicial decisions may emerge in several areas: valuation of the assets of the company, fiduciary duties of directors, and protection of minority shareholders. It would be beneficial if this body of jurisprudence is based on the fundamental company law and made applicable to limited liability companies as well.

Implementing Institutions
The procedure for establishing a company was considerably simplified in 1997 and the registration time was reduced to two to three weeks (from the previous average of four to six weeks). With the exception of a single visit to the Notary's Office to certify the company's bylaws, all other contacts are with a single institution—the Trade Registry Office in the locality where the company will be active. The Trade Registry is a public institution, organized by the Romanian Chamber of Commerce and Industry (RCCI), with offices in Bucharest and each of the country's 40 counties.

There are four steps involved in setting up a company in Romania:

1. First, it is necessary to go to the Trade Registry to see if the intended company name has already been taken. One usually asks for three names and then depending on the availability, reserves the preferred name and company logo for a prescribed period of time. This process is computerized and reasonable fast.

2. Next, the company must certify the articles of incorporation (Contract) and bylaws (Statute) at a Notary. In fact, the Contract and Statute can be comprised in a single document (Constitutive Act), which must be signed by all shareholders or their representatives and notarized.

3. Incorporation papers and necessary documents are then submitted to the Trade Registry for authorization by the mandated judge ordering the incorporation of the company. The company obtains juridical personality from the date of incorporation.

4. The Trade Registry then submits the registration papers for publication in the Official Gazette.

This is a far simpler procedure than that originally adopted in 1990. The earlier procedure required seven steps including an application to the Tribunal for a judicial decision granting authorization to set up the company. This application phase was usually a lengthy process. Now the assigned judge goes to the Trade Registry every day to handle registrations. Except for the visit to the Notary, the Trade Registry has become a "one stop" shop.

The Trade Registry is regulated by Act No. 26/1990, as modified and republished in 1998. The following is a synopsis of how the system works (Article references are to the Act).

First, the Ministry of Justice, in agreement with RCCI, established the norms for operating the Registry, the required forms, and record keeping requirements (Art. 12), which were published in the Official Gazette (Art. 12). At its own expense, the RCCI then established computerized Trade Registry Offices in Bucharest and in the country's 40 counties (Art. 9); RCCI pays for operating expenses of the Registry and for personnel costs (Art. 10).

The Ministry of Finance agreed with RCCI on the fee schedule for different types of corporate filings (Art. 11). Fees collected are divided as follows:

1. 8% to pay for the expenses of the actual registration.

2. 2% to the Ministry of Justice to pay for the judicial phase of the proceeding.

3. The balance to RCCI to compensate it for the establishment and operating expenses of the Trade Registry Office (Art. 11).

The Court makes an annual inspection of the Trade Registry Office operations as required by Article 8.

Based on a broad cross-section of the team's discussions with entrepreneurs, lawyers, bankers, non-governmental (NGOs), government officials, and ordinary citizens it is fair to conclude that Romanians are satisfied with the operations of the Trade Registry offices. The general comment was that the new procedures are a great improvement over the old way that company registrations were handled. One NGO that helps small business with business planning and corporate start-ups said that there is no need for them to get involved in the incorporation process because operations run smoothly at the Trade Registry. Indeed, the team's translator, who is establishing a private translation company, commented on the ease and efficiency of the process and the Trade Registry.

The favorable comments on the company registration process are not to suggest that the current system is ideal particularly from the American perspective. By U.S. standards registering a company in Romania is expensive (about $500 in fees) and slow (2-3 weeks compared with the extremely rapid process in the U.S.). A good part of the explanation is due to the fact that in the U.S. there is no judicial involvement in the company registration process whatsoever. From the U.S. perspective, the involvement of a judge contributes little of real value to the process and appears to be mainly a formality.

From the viewpoint of judicial efficiency and the sound management of scarce judicial resources, company registration creates an additional problem. Judges who are in short supply are taken away from their main duty—dispute resolution—and forced to review all business documents in order to approve a registration. This review is a purely administrative task that could be performed by an administrative arm of the court or transferred to an agency outside the court. It is difficult to see how judicial involvement protects the interests of third parties in their dealings with the new company or is otherwise beneficial in a legal sense.

On the other hand, judicial registration of companies seems to be a solidly established continental practice. Little evidence exists as to the likelihood of the practice being changed in Romania or elsewhere in continental Europe in the near future. Given this reality, the best approach is to streamline procedures and time lines, very much like Romania has done.

Although setting up a company in Romania is expensive by U.S. standards, the expense involved does not appear to strike Romanians as unreasonable. In fact, in several of the interviews the team received the impression that people felt that something as important as setting up a company could not reasonably cost any *less*. Whether that impression is right or not, it is accurate to say that none of those interviewed criticized the expense of company registration.

The fact that a private organization like the RCCI is carrying out a critical public function such as company registrations may strike some as inappropriate, curious or even dangerous. One might imagine a risk that the Chamber use its monopoly position to pressure new companies to become Chamber members or otherwise give the Chamber some special compensation or advantage. Yet no such allegations or concerns were expressed. On the contrary, we heard accolades about the way that company registrations were being handled. Several people expressed the view that if the Government had opted to set up the Registry offices as governmental entities, the system today would be far from operational. Work would still be ongoing in setting up the offices and the computers would not be installed yet. Whether this speculation is true or not, there seems little doubt that the public/private partnership spelled out in Law No. 26 did enable the registration system to begin operations quickly.

Thus, as a private institution operating in the public good, the Trade Registry seems to be living up to its mandate. The statutory framework for the Trade Registry appears to be comprehensive and reasonable. A formula for dividing fee income as a way for financing the system seems like an excellent example of public/private cooperation. However, without having examined RCCI's costs it is not possible to evaluate whether the actual percentile distribution of fee income is appropriate. There is no doubt, however, that setting up the Registry Offices must have been expensive and the RCCI should be entitled to recover its expenses.

As a totally computerized operation the Trade Registry is able to generate extremely useful data on new company formation, liquidations, and amendments of articles of incorporation for all companies throughout the country. The Monthly Statistics on company activity are an important economic indicator.

Between December 1990 and October 1998 there were a total of 725,100 company registrations in Romania. During the same time 18,824 companies were dropped from the company registry. A further 844,228 amendments and company notifications (unrelated to company formation and liquidations) were also filed during this period. This data is available broken down by different types of business organization (joint stock companies, limited liability companies, partnerships and sole proprietorships) for all 40 counties and Bucharest. Annual comparison charts show clearly yearly fluctuations in business start ups and liquidations since 1989.

Supporting Institutions

Romania has the full range of supporting institutions described in other sections of this report. In the private sector, there are law firms, NGOs, accounting firms, banks, legal publishers, and other economic actors that support the development of company law. New types of businesses (such as document processors and investigative services) enter on the scene to help new entrants to the marketplace. Universities, foundations, think tanks and for-profit companies sponsor seminars, conferences and workshops on different aspects of company law and company formation. Increasingly, attendees are willing to pay for business seminars—showing that companies and individuals really value the product rather than simply taking advantage of a free foreign donor-funded program. Professional associations develop in new specialties. On the state side, the courts, commercial courts, and administrative agencies become more assertive and competent in dealing with company law matters.

The path of change is not linear such as a steady march of progress in all sectors. Instead, reform in countries like Romania has proceeded in spurts—advancing, stumbling, and then surging forward again. Supporting institutions are key in fueling the demand for reforms which are sustained, tested by events, and have delivered over time.

D. Competition

1. Overview

Fair competition in the provision of goods and services is the cornerstone of the free market. Creating an environment in which such competition could flourish was one of the primary challenges facing the CEE/NIS in their programs of economic and legal reform. In the transition from the former state monopoly system, the passage of anti-monopoly laws became the focus of many legal reform efforts. In fact, foreign donors and client governments have often treated the passage of a new antimonopoly law as the chief benchmark of progress in law reform, and have commonly viewed implementation and institutional development as an afterthought. Detailed understanding of institutional constraints to implementation has been lacking. Our approach to the competition policy analysis will examine these constraints paying particular attention to supporting institutions, enforcement strategy, competition advocacy programs, and the problem of over-regulation.

Supporting institutions are critical to proper development of a regulatory and enforcement regime for competition policy. To cite just a few key linkages, skilled lawyers or consumer groups may be needed to identify and bring to the attention of antimonopoly authorities various antitrust violations; academics on law, business, and economics faculties may be helpful in advancing the state of understanding of local markets and the application of law; trained judges are needed to rule on antimonopoly cases; compulsory process is necessary to obtain business records; business records must be kept in a format consistent with modern accounting methods; and so on. While development of none of these institutions is as critical to implementation as internal development of an antimonopoly agency's capabilities, their evolution is ultimately of great significance to the establishment of the rule of law and must be tracked in some detail to present an accurate picture of the complexity of a functional enforcement regime.

A phased, targeted enforcement strategy ensures that an antimonopoly agency—especially one lacking in certain resources—does not attempt to assume more responsibilities than it can handle. It also ensures that it attacks some of the most important, yet politically attainable, problems first, thereby boosting its credibility and gaining public trust. An enforcement portfolio needs to include both critical actions against government restraints on competition as well as a handful of politically more palatable, yet less helpful, cases (e.g., antimonopoly cases, if they fall within the agency's purview). It also needs to include voluntary compliance programs and public education efforts that lay the groundwork for an enforcement program that is perceived as fair, justified, and sensitive to business community views.

A competition advocacy program is often overlooked in the midst of client government and donor preoccupation with high-profile enforcement actions. Yet this kind of education, publicity, and policy advocacy program is arguably the most critical type of activity that an antimonopoly agency can take in a transition economy. The reason is simple: most of the post-Soviet world suffers from excessive regulation and *government-directed restraints on trade that impede easy market*

entry (e.g., exclusive licensing arrangements). Perhaps the highest-priority and most effective steps that an antimonopoly agency can take are to lobby assiduously for the elimination of over-regulation generally and removal of particular restraints. Such activities will not only have a beneficial effect on competition, but will also tend to stem some of the worst *corruption* problems stemming from exclusive dealing arrangements brokered by ENI governments.

Finally, a trenchant inquiry into competition policy implementation must examine whether antimonopoly authorities are reflexively *exercising regulatory powers—e.g., industrial policies that tend to affect price and output—that are precisely contrary to the central objectives of a competition policy agency*. In many transition economies, antimonopoly agencies are often pressured by domestic business fear of foreign competition or by consumer outrage over high prices to engage in result-oriented manipulation of market structures. Often, donors are unaware of such interventions or fail to appreciate its political or cumulative economic, impact. It is therefore critical to ascertain the degree to which this is occurring in order to critically assess overall implementation of competition policy.

Antimonopoly laws encompass one part of the legal framework that is an essential element in any free market economy. Competition increases market efficiency by leading to lower prices, reduced inflation, improved technology, a broader array of product offerings, and a reasonable supply of goods. Markets remain open through a combination of open international trade, and domestic laws and international treaties that limit monopoly behavior. Domestic legislation typically includes laws that assure market information transparency, public regulation of so-called natural monopolies such as electric utilities, the deregulation of prices, and the supervision of markets by government bodies to assure competition.

2. Diagnostic Findings

Romania, along with the other Central and Eastern European (CEE) countries, inherited a highly concentrated industrial structure with state owned enterprises monopolizing or otherwise dominating markets. The continued dominant position of some entities, even post-privatization, is a major impediment to the growth of a new private sector. Because of their marketplace dominance, enterprises that are monopolies or oligopolies prevent new firms and product offerings from reaching the consumer. Further, smaller firms wishing to supply dominant companies are potentially subject to burdensome conditions.

Romania has followed a gradualist approach in developing its antimonopoly legislation. Soon after the 1989 revolution, the Government of Romania recognized the need to develop legislation in this area. It laid out *general* principles of competition in both Law 15/1990, Restructuring of State Economic Units and Law 13/1991, Unfair Competition. But these laws neither established detailed definitions of monopolistic behavior nor set out applicable sanctions.

The principal competition legislation was not passed until 1996. Competition Law 21/1996 was promulgated on 10 April 1996 and became effective on 1 February 1997. This legislation establishes the basis for competition policy in the country including the principles of market

competition and price decontrol. The law generally prohibits agreements among market participants that will limit, prevent, or distort competition in Romania. Exemptions may be granted if an applicant can show that there may be a significant improvement in production, product distribution, quality, and technology and that the improvement may strengthen the competitive positions of small and medium sized enterprises both in the Romanian domestic market and overseas. A dominant position in the market place is not, *per se*, prohibited.

Implementing Institutions
There are two principal government bodies that are responsible for implementing Competition Law 21: the Competition Council (the Council) and the Competition Office (CO). Both these organizations were established on 6 September 1996 pursuant to Law 21.

A president with the rank of Minister and three vice presidents with the rank of secretaries of state run the Council. The President of Romania, in consultation with the Parliament, appoints the Council members for a 5-year term. The Council is an adjudicative body that also has rule- and policy-making authority as well as limited internal investigative resources. The Council can and does apply sanctions to both private and government entities that violate the Competition Law. Decisions are based on investigations by either the Council or the CO. The Council's decisions are exercised independently but can be contested. Challenges are made through the Bucharest Court of Appeals with recourse to the Supreme Court of Justice. The Council also provides expert advice to other government agencies on competition policy and local public administrators prior to their restructuring of public companies.

The Competition Office's (CO) organizational and personnel structure was approved by Government Decision 775/6.1996. The CO was originally part of the pre-1989 "State Committee on Prices" within the Ministry of Finance and had responsibility for regulating prices. By 1991, as a result of the emergence of a freer-market philosophy, the CO, operating as the Department for Prices and Protection of Competition (DPPC), started to refocus its efforts on price de-regulation. By October 1996, the DPPC changed its name to the Competition Office and moved from the Ministry of Finance to an independent government agency.

The CO has several roles. First, it continues to be involved in price control monitoring and implementation focusing principally on *regies* autonomous and natural monopolies such as utilities (power), local transportation (rail, river, and municipal), communications (postal and telecom), and water and sewage. The regulatory initiative is now relatively minor as prices are now indexed each month to either the Consumer Price Index (CPI) or the exchange rate. Further, many monopoly situations are disappearing. Second, it provides surveys and economic analyses of prices in various sectors, seeking patterns that suggest restrictions on competition. This information is shared with the Council and may serve as the foundation for prospective complaints emanating from the Council. Third, the CO is the principal information conduit to both the Romanian public and international bodies with respect to quantitative and qualitative information on competition in Romania. Fourth, the CO serves as a liaison with international organizations and the EU. Fifth, it is the principal investigative authority that deals with infringements of the

Competition Law (While the Council also has investigative authority, its resources are more limited.).

The CO is both reactive and proactive. It may launch an investigation based on a complaint, or initiate an investigation on its own or in conjunction with the Competition Council. All investigations are carried out in accordance with rules and procedures set out by the Competition Council and findings are submitted to the Council for its ruling.

Romania has made significant strides in developing legislation that promotes competition and in creating institutions that will support the implementation of this legislation. Systemic problems have been identified in the following areas.

Policy Issues:	▪ Debate continues about economic and political risks resulting from vigorous enforcement of antimonopoly rules and regulations. The dichotomy is manifested by the disparate and sometimes conflicting roles played by the Council and the CO. - The former is a newly created body and the champion of competition. - The CO is considered staid because of its earlier functions and the long tenure of its staff. Many of its long-term, senior staff members are unwilling to cooperate with the Council in activities as fundamental as training and are reported to be less than cooperative in some investigations.
EU Accession	▪ Romanian legislation and regulatory reform is being undertaken to meet EU accession standards. However, converting this framework to practice is proving to be problematic. This is manifested in training sessions with EU members where Romanian participants frequently come up with vastly different legal "case" conclusions than their Western European counterparts. The differences may be attributed to different economic environments, training, and a lack of experience in dealing with anti-competition regulation.
CO Staffing Problems	▪ Inability to hire and/or hold on to quality economists, accountants, and lawyers because of budgetary limitations. ▪ Significant shortfall in actual staffing levels (900 staff positions but only 450 employees). ▪ Inadequate training and budget for training of existing staff. ▪ Lack of necessary industry specialists needed to conduct inquiries.
CO and Council Information Issues	▪ Difficulty in developing and maintaining comprehensive databases on a large cross-section of industries, thus compromising investigations and follow-up analysis.
CO Process Issues	▪ Inadequate procedures for dealing with investigations including methodological problems such as how to conduct investigations, how investigators should interact with companies subject to inquiries, how to gather information, and analytical precepts. ▪ Inter-office organizational problems that compromise the effective use of CO staff in information gathering and analysis roles.

Judicial Issues	▪ Judiciary that has difficulty in effectively dealing with antimonopoly issues because of inadequate training in economics and business. ▪ Judges who are not fluent in the relevant law. ▪ Judges who do not specialize in antimonopoly matters.
Enforcement Issues	▪ Prioritization of investigations (e.g., large enterprises vs. small firms). ▪ Lack of clear standards related to pursuing investigations without stifling competition.
Council and CO Cooperation	▪ Ideological differences ▪ Unclear delineation of responsibilities ▪ Inadequate coordination and cooperation with respect to dialogue over policy issues, enforcement, and training.

The effective implementation of the Competition Law and its subsidiary regulations requires reasonable legislation, effective implementing agencies with adequate resources and staffing, a receptive society, and competent management. Romania has reasonable legislation and the management of both the Council and CO are insightful and capable. They have achieved a great deal based on recent data on the first reporting period for these organizations. Between February 1, 1997 and December 31, 1997, the first reporting period, 72 anti-competition cases were registered. Fifty-three of these were resolved during this term and 19 cases involve on-going examinations. Council-initiated complaints have been sustained in court, and significant sanctions applied to both private companies and government bodies. Ministries and the private sector now know that anti-competitive behavior is being scrutinized and that penalties will be applied. But, significant hurdles remain. Structural improvements need to be made in the CO. Technical assistance and training will not resolve fundamental problems associated with inadequate remuneration. Further, better co-ordination is needed between the Council and CO to ensure that there is effective and consistent enforcement of the Competition Law and related legislation. This requires that there be agreement between the two organisations with respect to which one will play the lead role. Cross-training and shared technical assistance programs would also reduce costs and facilitate cooperation.

Implementing and Supporting Institutions

To facilitate increased competition, Romania needs to effectively deal with product standards that are used to keep competitive products out of its marketplace. At the present time, the country has multiple regulatory bodies, standards, and compliance requirements which, cumulatively, may create a significant burden to firms trying to compete in Romania. These firms are faced with increased compliance costs and interminable bureaucratic procedures that prolong the process of getting products approved for the market.

The Competition Council and the Competition Office have not adequately addressed these issues and other government bodies have explicit authority over many of the regulations that are proving to be anti-competitive. These government bodies include the Ministry of Agriculture, the Office for Consumer Protection (established by Decree No. 21/1992), and the Romanian Institute for Standardization. Generally, goods imported into Romania need to comply with rules and regulations concerning health, safety and labeling. Many goods may qualify for the Romanian market by complying with EU designated norms (e.g., ISO 9000) and by having Romanian

language labels. The application of these standards is not, however, uniform. Thus, despite being in compliance with EU requirements (e.g., Decree No. 629/1996), some classes of capital equipment are subject to separate safety testing and certification (e.g., earth moving equipment). Another example of this problem is found in food products. These are subject to sampling, testing and analysis at the Ministry of Agriculture. Once they have met the Ministry of Agriculture's standards, the products must be granted a separate import license by the Department of Agriculture. The entire transaction time may extend out to 6 months. Interestingly, exceeding EU standards has apparently been used to exclude products from the Romanian market. Respondents reported instances in which US origin products that exceeded the EU standards were treated as non-conforming and import licenses were withheld.

In summary, the product testing and certification requirements result in pre-market clearance procedures and costs and result in significant delays in the sale of products. Company submissions are often made to several government agencies some of which have conflicting regulations. This increase in the number of pre-sale approvals increases costs, further delays market entry, and reduces competition.

The Competition Council and the Competition Office may be more effective in fostering a competitive environment in Romania if they can be made truly independent, agencies. The politicization problem is illustrated by initiatives attempted in utility deregulation. The Competition Office (CO) has been responsible for the regulation of electric utility rates. It has initiated rate deregulation. The CO has also developed a plan to have the utility industry break itself into multiple parts including power sales, power transmission, and power generation. A goal is to create competing operators/suppliers for each of the original parts of the electric utility. This plan has apparently met with resistance from the Parliament, SOEs, and newly privatized companies that continue to prefer a "closed" system and want the competitive advantages associated with subsidized energy. Unfortunately, the size of the Romanian market and the heavy cost associated with developing a new distribution infrastructure precludes the introduction of outside competitors that otherwise might drive prices down. The uncertainty here also poses problems for privatization initiatives in this sector. The net effects include the following:

- Energy costs remain too high
- New infrastructure is not developed
- Industries that are particularly price sensitive about energy costs do not come into the country
- There are fewer foreign investment opportunities for foreigners, and,
- The development of a market economy is further delayed.

E. Contract

1. Overview

No field of law is more essential to the operation of a free market than the law of contract. A consistent, predictable set of principles binding parties to the terms of their agreements underlies all of commercial law. It is, thus, an obvious and indispensable component of this analysis of commercial law reform in the CEE/NIS.

The countries examined in this assessment are at various degrees of transition from a system of state planning where contract law played only a peripheral role. Normal contract law did not exist in the planned sector of the economy. It did exist, however, in two limited areas including foreign trade relations (conducted by a limited number of state agencies) with non-communist countries, and in non-business agreements between private citizens (e.g., sale of a house with payment in installments). With these and a few other minor exceptions, it was forbidden to make all types of business agreements.

With the end of communism, laws were passed allowing contractual agreements. The starting point in our research is the nature of this basic contract legislation. Some elementary questions concerning these laws include:

- Whether the framework law embodies a market-oriented approach to contractual relations based on freedom of contract;
- Whether economically (or commercially) significant types or classes of contract, such as those for buying and selling land, prohibited or unenforceable;
- Whether imperative rules limiting the freedom of parties to set terms exist (e.g., as in Russia where some critics have claimed that the imperative rules on franchise law are so slanted toward the franchisee that they discourage the use of franchising);
- Whether parties are free to agree on customized terms relating to liquidated damages, arbitration, choice of law, and related matters; and,
- Whether adequate enforcement mechanisms are available in the event of breach (e.g. penalties, money damages, specific performance).

A major area of inquiry will concern contract enforcement. This involves four issues:

- Quality of court personnel
- Training of court personnel
- Independence of the courts from government intervention, and,
- Enforcement powers.

Given that the institutional capacity of the commercial courts cuts across most of the areas under study, it will be dealt with separately in Section I below.

2. Diagnostic Findings

Legal Framework

Romania has a long and continued tradition of development of contract legislation. The Civil Code dates from 1864 and has been amended several times (more substantially in 1913 and in 1920). It is modeled closely on the Napoleonic Code and the Italian Civil Code. It provides the basic framework for property rights and private transactions. The Civil Code was left in its original state after the communist takeover, and it was not necessary to introduce new market—oriented contract principles after the revolution in 1989.

While during the socialist period most of the relations between state-owned enterprises were regulated by administrative decisions, the application of the contract laws remained in two areas—the foreign economic relations, and the transactions between private parties. This limited application of the contract legislation was enough to keep the Civil Code from falling into complete disuse. Civil law courses were one of the cornerstones of the university curricula and the Romanian legal professionals have adequate experience in this area.

A key element of the contract law in Romania is the Commercial Code, which dates from 1887. The Commercial Code provides comprehensive regulation of the content and exercise of ownership rights, sales of goods, agency, commission and other essential business transactions. Since December 1989, many parts of the Commercial Code have been supplemented by new legislation based on current European standards. In 1991 most of the Code was replaced by Company Law 26/1990, as amended by Emergency Ordinance dated June 27, 1997. Book III of the Commercial Code, dealing with bankruptcy, and the related regulations were replaced by the Bankruptcy Law 64/1995, as subsequently amended. Secured transactions (discussed in the Collateral Law section) are one area clearly in need of improvement.

Because of the prevailing economic conditions Romania failed to develop some of the new areas of contract legislation, particularly leasing, franchising and factoring laws. Certain of those legislative gaps were filled after 1989, including the Leasing Law 90/1998 which became effective in March 1998 and amended Emergency Ordinance 51/1997 which previously regulated this particular matter. The Franchise Law was approved by the Government through Ordinance No. 52/1997 and then modified by Parliament in recently enacted Law No. 79/1998.[10]

The initial text of the Leasing Law (i.e., Emergency Ordinance 51/1997) restricted some arrangements of the Franchise Law with regard to the obligations of both the Lessor and the Lessee (Articles 4 and 5). The Leasing Law has recognized the restrictive nature of these provisions by stating that the Lessor and Lessee shall have the right to negotiate and stipulate their rights and obligations in a particular leasing contract. Further, the original text of the law

[10] Both laws were passed in line with the existing practice – first the Government issues an Emergency Ordinance, and after several months the Ordinance is being submitted to the Parliament for approval. In the course of the approval some changes are made in the original text. In such way for a considerable period of time uncertainty exists as to the application of the new regulations. Instead of accelerating the process of application of the new law, this process is in fact delayed, because the interested parties wait to see the final text and act accordingly.

introduced unclear and cumbersome administrative formalities and ambiguities with regard to the taxes and custom duties. Because of them the expected increase in leasing operations did not materialize. Ordinance 51/1997 became one more example of legislation introduced without prior review of the necessary implementation arrangements and without detailed analysis of the consequences for the affected economic agents.[11] The problems of the law are not related to the contractual framework, which is created by it, but to the inadequate tax, accounting and fiscal arrangements.

Franchise operations appeared in the former socialist countries in Europe only after the political changes in the late 1980s. Franchising as a contract was a completely new area, not regulated by the existing contractual legislation. For the first time in Romania the law defines a new contractual form, not regulated in the Civil or the Commercial code. The parties are defined by the law as "merchants", which is an important and appropriate distinction, making them subjects to the commercial legislation and not to the general civil law. This distinction has important contractual and enforcement consequences. The Law emphasizes the freedom of contract principle. In comparison to the initial Ordinance the final text has reduced the number of clauses that the franchise agreement must expressly contain. It allows the parties greater flexibility in determining the content of the agreement within the general principles of the Romania commercial legislation. The law fails to address several important issues, which are not related to the contractual freedom of the parties, but rather to their tax and customs obligations, and to the applicable accounting rules. The two most recent examples of the Romanian contractual legislation confirm the following earlier observations:

- The drafters have good theoretical understanding of the underlying problems of the economic legislation, but little or no practical experience in terms of day to day business operations;
- No models of the application of the laws have been developed prior to their enactment; and,
- Little or no consultations with practicing professionals were held prior to the preparation of the draft.

Romania recognized the importance of the existence of a comprehensive system for dispute resolution, and in particular of the arbitration as preferred way for handling of international contractual disputes. The country is signatory to the New York Convention of 1958 regarding the recognition and execution of foreign arbitration awards. Romania is also a party to the European Convention on International Commercial Arbitration concluded in Geneva in 1961 and the International Convention for the Settlement of Investment Disputes (ICSID) concluded in Washington in 1965. Arbitration awards are enforceable through the Romanian courts under regulations similar to those in the developed market economies. The problems with the application of the contract laws are more related to the enforcement, because of the inability of the system to handle efficiently the large amount of new cases, resulting from the change in the

[11] For example, the public institutions set forth in the Ordinance for the registration of leased goods were never established, and the custom duties provisions were in conflict with the new custom duties code that also came into effect in August 1997 (Law No. 141/1997).

economic conditions in the country. Enforcement problems are discussed in the section on the Judiciary.

With the exception of the secured transactions, the contract law system is established in Romania in terms of statutes and does not have substantive deficiencies. It is supported by extensive court practice (140,000 commercial cases in 1997), which has not been analyzed so far.[12] There are no restrictions of the contractual autonomy of the parties, which can enter into any form of commercial contracts. Further development efforts should concentrate more on the necessary implementation arrangements.

Implementing Institutions
Under the Communist regime, Romania had no independent judiciary. Courts were considered as specialized state offices with specific functions within the overall governmental structure. The Ministry of Justice (MOJ), under the direction of the Communist, controlled court administration and the political and ideological conformity of judges. As the all-encompassing state planning could not be challenged, only disputes between individuals concerning their personal transactions could be referred to the civil courts. The judiciary lacked secure tenure of office and many physical amenities—at times even courthouses. Thus, when the totalitarian regime of Nicolae Ceausescu fell on December 21, 1989, and the reform movement began, the judiciary had a difficult legacy to overcome.

A new Constitution, promulgated by the Constituent Assembly on November 21, 1991 was entered into force on December 8, 1991, following approval in a national referendum. The new Constitution abolished the official position of the Communist Party, established a system of democratic pluralism, and separated legislative, executive and judicial powers. Articles 123 to 133 of the Constitution describe the "Judicial Authority." Judges are independent (Art. 123), irremovable (Art. 124), and are prohibited from holding any other office except that of an academic professor (Art. 124). The Constitution also established a Constitutional Court—separate and outside the three branches of government—to rule on the constitutionality of laws.

As a means to safeguard the independence of the judiciary and also to reduce the influence of the Ministry of Justice over the courts, the Constitution established a Superior Council of the Magistracy ("SCM") with three major functions:

(1) To nominate judges and public prosecutors for appointment by the President of Romania. These proceedings are presided over by the Minister of Justice who does not have a vote.
(2) To act as a disciplinary council for judges, with the President of the Supreme Court of Justice presiding over the proceedings.
(3) To decide upon the promotion and transfer and sanctioning of judges in accordance with the law.

[12] The Ministry of Justice does not maintain statistics of the breakdown of commercial cases in the courts.

The SCM consists of magistrates elected for a term of four years by both Houses of Parliament in a joint session. As a body, the SCM is far from independent—as non-voting chairman of the SCM, the Minister of Justice still exercises an important role in the selection of judges. In general, the MOJ has a large amount of influence on the judiciary in that it continues to exercise control over court administration and the budgetary process for the courts.

The 1991 Constitution and the 1992 Law on the Reorganization of the Judiciary brought about a profound transformation of the judicial system. Romania now has a three-tiered court system, consisting of first-instance courts, intermediate appellate courts, and a Supreme Court. Leaving aside military courts (which are not dealt with here), there are four different courts, as follows:

Judecatorii **-** The first tier in the court system is the judecatorii, which is a trial court of general jurisdiction, and only hears cases in the first instance. Romania is divided into 40 counties (judets), and there is one or more judecatorii in each county. Presently there are 167 of these courts in operation. Judecatorii judges have life tenure, subject to removal by the SCM for statutorily defined reasons. All cases in the judecatorii are heard by one or two-judge panels, depending on the type of case.

A court President, who in larger courts may be assisted by one or two court Vice Presidents, runs each judecatorii. The President, in addition to maintaining the caseload, is responsible for the court's organization and administrative affairs and makes case assignments. In larger courts there may be specialized panels for civil and criminal matters, and for commercial cases as well. Each judecatorii has its own prosecutor's office.

Tribunals **-** Tribunals hear appeals from the judecatorii courts. The tribunal also acts as a court of first instance for more serious criminal matters (e.g. attempted murder) and in civil cases where the award sought exceeds ten million lei (around U.S. $1000). Currently, Romania has 40 tribunals corresponding to the number of judets in the country. In addition, there is a city court in Bucharest that for all intents and purposes functions as a tribunal.

Tribunals may be divided into sections depending on the caseload and the number of judges assigned to the court. The most commonly used sections are civil, criminal, commercial, and administrative law. A panel of three judges hears appeals, while a two-judge panel resolves first instance cases. The SCM appoints presidents of the tribunals who have responsibilities similar to those for the judecatorii. As with the judecatorii, each tribunal has a related prosecutor's office.

Courts of Appeal **-** Prior to the Communist era, Romania had 12 Courts of Appeal. The 1992 Law on Reorganization of the Judiciary effectively recreated this level of court and since that time, 15 Courts of Appeal have been established. In this appellate system, a three-judge panel hears appeals from tribunals from within the panel judges' jurisdictional territory. This is the final level of appeal for cases that originate at the *judecatorii* level.

Supreme Court of Justice **-** The Supreme Court of Justice, with a total of 60 judges, is organized into civil, criminal, commercial, administrative, and military sections. Only a relatively small

number of appeals reaches the highest level, and cases that originate at the judecatorii level cannot be appealed to the Supreme Court.

Under the Constitution the President and other Judges of the Supreme Court of Justice are appointed for a renewable six-year term of office. Before the Constitutional Court was created in June 1992, the Supreme Court of Justice used to rule on the constitutionality of legislation. Now these cases are referred to the Constitutional Court for decision.

Caseload & Backlog

Most transition economies have experienced an explosion of litigation. The most obvious cause for increased legal cases is that the move to a free market economy has resulted in the enactment of many new laws and thus new types of cases in the commercial and property area (e.g., land restitution). Non-transparent markets, high transaction costs, and uncertain and unclear laws also have added to the increase in litigation. Also, many new entrepreneurs have entered the market, and there is a lack of the long-term mutual business relationships that are an important stabilizing element in contract relations. This has added to the caseload volume. Finally, economic instability, particularly high inflation, has increased the likelihood of contractor defaults leading to more litigation.

Romania has been no exception to this phenomenon of increased litigation. In the three years following the 1989 Revolution the judicial caseload doubled from 600,000 to 1,200,000 cases. This increasing trend has continued but at a lesser rate. For 1997, according to MOJ statistics, the courts dealt with a total of 1.8 million cases, consisting of 1.4 million civil cases and 400,000 criminal cases (the MOJ treats a matter as a separate case each time it reaches a different level of court).

Of the 1.4 million civil cases, 114,000 were commercial cases. Of the commercial cases, 45,000 were in the judecatorii, 40,000 in the tribunals, and 29,000 in the Courts of Appeal. The Ministry of Justice does not maintain statistics on the breakdown of commercial law cases among the various categories of commercial law.

Many of the countries in Eastern Europe adopted a review process for judges who served under the Communist regime. For example, in neighboring Bulgaria judges who had compromised themselves during the Communist years were subject to removal during the 90 days following the entry into force of Bulgaria's 1991 Constitution. However, in Romania no such "cleansing" of the judiciary was carried out although many judges did resign to pursue a more lucrative career in private law practice. The resignations opened up the way for many newly appointed judges. In keeping with the Civil Law tradition, Romania draws most of its judges from the ranks of recent law school graduates and young lawyers.

In the first few years of the transition from the Communist regime, the size of judiciary did not keep pace with the increasing caseload. From 1989-92 while the caseload doubled, the number of

judges only grew from 1,350 to 1,600 – a rather modest increase. However, the last few years have witnessed a considerable increase in the number of judges.

Currently, there are 3,696 judges in Romania, divided among the four levels of court as follows:

Court	Number of Judges
Supreme Court	60
Courts of Appeals	424
Tribunals	933
Judecatorii	2,279
Total	**3,696**

Sixty percent of the total number of judges is new since 1989, and most new judges are entry-level magistrates.

At the judecatorii level each judge handles on average 800 cases per year. The comparable numbers for the tribunal and court of appeal are 435 and 244, respectively.

According to the latest European Commission (EC) Report on Romania's Progress towards EU Accession, "judicial proceedings can take from 6 months to several years, particularly in commercial matters. This period needs to be reduced." It is difficult to gain precise information on case disposition time. There are no statistics available which indicate the exact time taken to adjudicate a case. The EC reports also highlight cases that are concluded by the end of the fiscal year, which coincides with the calendar year.

Although there are statistics which show the percentage of criminal cases outstanding by calendar quarter and the number of civil cases not completed by year-end, they were not made available to the team.

There are many reasons for delays in the adjudication of cases and many changes that could be pursued which would shorten the time for case disposition. An excellent American Bar Association/Central and Eastern European Legal Initiative (ABA/CEELI) Report on Court Administration in Romania offers recommendations that focus on ways to increase court efficiency. While the report has been provided to the government, including the MOJ, none of its recommendations have been implemented. Among some of the key recommendations are the following:

- Eliminate the complicated summonsing process which parties use to avoid being served;
- Increase authority of judges to help speed progress of cases;
- Reduce administrative responsibilities of court presidents and vice presidents;
- Centralize responsibility for supervision of auxiliary staff;
- Provide public access to information about pending cases by telephone;
- Modernize court filing system;
- Utilize for-pay copy machines for the public; and,

- Adopt specified measures making it easier for judges to prepare for hearings;

Institutional Constraints

Limited Resources - The recent injection of new judges into the system has been beneficial, as it has reduced the influence of the old *nomenklatura* judges. However, as many new judges are drawn from the ranks of recent law school graduates and new lawyers, then the skills that they acquire in law school are of utmost importance, and this is the source of one major concern. Many individuals interviewed expressed the view that there are not enough practical, case method, problem-solving courses in the law school curriculum. Also the explosion of start-up law schools after 1989 has made it difficult for the authorities to enforce high standards of legal education. Some of the new law schools are matriculating excellent lawyers and judicial candidates; unfortunately too many of these schools are not, was a view expressed by many interviewees.

An added factor is that many of the new judges who have recently entered the system do not look upon judging as a career. Rather they see court duty as a relevant period, during which they are making financial sacrifices, while garnering substantial experience that will be beneficial in a future lucrative private practice. To the extent they take good attitudes, knowledge and skills with them, the entire country gains; but, to the extent that their replacements receive training in a relatively short period, the system suffers.

A related point is that the careers of those judges who remain in the system tend not interested self-improvement. Incentives for change are few, and there seems to be no corresponding linkage between training and promotion, training and retention, or training and compensation contemplated in legislation.

In addition, working conditions for judges are poor and not conducive to effective performance. Court buildings are old and overcrowded (with three judges to an office, in some cases) and lacking in the necessary security equipment. Many courts lack qualified support staff and do not have adequate office equipment. In most courts case files are still opened in the age-old way of sewing the complaint and accompanying documents to a file folder with needle and thread. Most judges do not have secretaries, research assistants, or computers. They often type their own decisions on mechanical typewriters, do their own research, and are personally responsible for tracing all the information (factual and legal) they need to reach a decision. Judges also lack access to necessary source materials—in one court 20 judges had to share a single copy of the Official Gazette.

The salary levels for judges are not conducive for attracting and keeping the best candidates on the bench. Even with recent salary increases, a junior judge makes on average only U.S. $230-250 a month, which is far below what a lawyer can make in the private sector. Many judges move to the private sector after only a few years on the bench because they say they cannot "afford" to stay.

Some countries have attempted to legislate a pre-specified amount of the national budget for the judiciary as a method for increasing judicial resources. This percentage is usually in the range of two to four percent.

Corruption - Corruption is a serious problem for transitioning Central and Eastern Europe countries. It creates conditions that destabilize governments and the reform process. Unfortunately, Romania has not been spared from the negative effects of corruption.

There is a strong school of thought in Romania that views corruption as a part of the national mentality and value system. The state's redistributionist philosophy (the more we control the more we distribute) during the 45 years of Communist rule and again during the recent socialist government meant that over a long period of Romania's history the state worked against rather than in defense of the interests of the individual. Within the structure of national values, the notion of the public good has been vague and depersonalized. Owing to these historic or cultural roots and to the delays in market reforms, of Romanian citizens are tempted to use public office for private gain, in other words are prepared to corrupt or be corrupted.

Although it is hard to quantify the extent of corruption in the judicial system, there is no doubt that the potential for corruption exists at many stages of the judicial process. During the diagnostic, the team learned that summons clerks are sometimes paid <u>not</u> to deliver a summons. Some lawyers even pay court staff for preferential treatment such as expediting certain actions like providing copies. Files can also be lost or found for a price. One hears of businesses hiring a "special purpose" lawyer for a certain case that they cannot afford to lose—the lawyer's expertise is knowing which judge to get on the case and how to make it happen. In such a case the mere assignment of a particular judge on the case may be enough to predetermine the outcome. In many cases money does not change hands. A favor is done with the expectation that it will be returned when needed. Besides judicial corruption, bribery at the prosecutorial level is an added problem in criminal cases, where the prosecutor has broad discretion to decide whether or not a case should be brought to trial.

One way to combat corruption is through a public administration reform program, aimed at restructuring public services to increase their efficiency, transparency and reliability. One of a country's most important institutions is a professional and motivated civil service, with selection and promotion based on merit rather than patronage. A well-performing civil service may be a potent force for resisting corruption. In Romania, the Law on Public Administration (Law 69/1991) replaced the Communist legislation. To date there has been no reform of the Romanian Civil Service Code, although the Law of the Public Servant was on the Parliament's reform list in the last legislature. Experience in other countries has shown that civil service reform may be an important tool to counter corruption by court staff who, as gatekeepers to the adjudication system, are well positioned to extract bribes.

Measures to strengthen the courts and make them more efficient also have an anti-corruption effect as well. A broad cross section of NGOs, members of Parliament, state and municipal

officials, and judges is needed to build an anti-corruption coalition. Cooperation with the media is a key part of a successful anti-corruption campaign.

More openness and transparency in court cases, together with less discretion on the part of officials and more automatic functions, will speed up justice and also discourage corrupt practices. Among the key judicial reform/anti-corruption reforms are:

- Changes in existing law to provide for serious sanctions against lawyers who abuse procedural rights by intentionally delaying court proceedings;
- Development of a system for summoning witnesses in order to preclude the possibility for intentional delays of court hearings;
- Creating institutions for alternative dispute settlement;
- Implementing filing systems that guarantee speed and reliability in the processing of case files and secure swift and easy access of citizens to the information they need;
- Developing a system for distribution of cases among various magistrates based on objective criteria, precluding the possibility for selecting a specific magistrate to work on a particular case; and,
- Implementing the principle of rotation of magistrates and staff working in sectors with a high risk of corruption.

The goal of a serious judicial reform program should be to build a truly independent, impartial, high quality judiciary that commands respect both domestically and internationally. The task is monumental, but far from impossible.

One factor that should not be overlooked in the ways to achieve this goal is the European Union (EU) accession process. Romania clearly wishes to join the EU as quickly as it can, and performance of the judiciary is an important benchmark on the path to EU membership. In the most recent report on Romania's progress towards accession, the European Commission highlighted these recent measures that were taken to strengthen the judiciary:

- The Law on the Organization of the Judiciary was amended in the Spring of 1998 to define judge panels at all levels of jurisdiction. This measure has accelerated procedures;
- The National Institute of Magistrates (NIM) has been created and is training judges and prosecutors;
- Unsuitable judges have been removed. In June 1998, seventeen judges of the Constitutional Court were not reconfirmed because of their repeated infringements of existing legislation on property; and,
- The ombudsman function created in the Romanian Constitution (the "People's Advocate") is now operational.

The Romanian push toward the EU combined with an aggressive Minister of Justice (MOJ) who has articulated a wide-ranging reform agenda has created a favorable climate for serious judicial reform. The recently issued 170 page Ministry of Justice White Paper, covering the period December 1996-December 1998, gives the reader a good idea of the extent of these reforms.

Among the most impressive measures to elevate the status of the magistracy—including both judges and prosecutors—are the following:

- A 300% increase in magistrates' salaries;
- Allowing revenues generated by judicial stamp taxes to be retained in the MOJ and to be used to finance the reforms;
- Re-activating the National Institute of Magistrates (NIM) which had been established in 1991 but had been allowed to become moribund;
- Instituting a training year at the NIM as a pre-condition to being named a judge; and,
- Establishing public competitions for all appointments of magistrates.

As salary gains take hold, judicial vacancies will be more readily filled and judges will be retained in service in greater numbers. Better-trained judges and improved court management practices should lead to enhanced public respect for the judiciary. This will encourage judges to trade earnings for prestige as occurs in other countries including the United States. The usual pattern in Romania and other Eastern European countries today is for women to fill the less prestigious office of judge while men opt for careers as a prosecutor. It is also logical to assume that as salaries become more attractive and prestige builds in the job, more males will apply for judgeships.

In recent MOJ-sponsored competitions for judicial vacancies, these factors seem to have been in play. During the past two years there were over five separate competitions in which more than 5,000 law graduates and lawyers competed for judicial and prosecutorial vacancies. Eventually 663 candidates were selected. This is a far cry from several years ago when it was hard to interest young lawyers (particularly male) to serve on the Bench.

Judicial Training - Currently over 200 trainee judges are studying at the NIM – a considerable accomplishment considering that the NIM was all but inactive several years ago. Although recent governmental support for the NIM is laudable, only a viable Government of Romania (GOR) investment over the long run will maintain it. The GOR will want to finance the NIM only if it is seen to be productive, useful, and essential. Therefore, the NIM will need to demonstrate in a very convincing way that it is living up to the expectations of changing judicial attitudes, behavior, knowledge and skills. To achieve that end, there will have to be "quality checks" of how its "products" judges-function. Simply giving tests at the end of courses would not be an appropriate evaluation of the quality of the product, nor would be comments by judges at the end of the course about content and presentations. The only valid evaluation is to check in the courts to see that judges and other trained personnel are putting into practice what they learned. A number of evaluation devices can be set up, but the basic point is that training must be seen to be making an important difference in the judiciary if the NIM is to be financed over the long haul by the Government of Romania.

Although training alone will not solve cases of judicial corruption, enhanced salaries will attract better candidates. More transparency in case assignment will help, as described in the section

above. Also a strong government anti-corruption campaign will cause those inclined to "return favors" to think twice before committing themselves.

As the above indicates, although there are many constraints facing the Romanian judiciary, the mechanism for overcoming these constraints is clear and Romania seems to be on the right path. It is also a path that coincides with EU Accession. The reform program that the Minister of Justice has carried out over the past two years will produce positive results if continued with resolve. The converse is likewise true. These constraints can only be removed by Romania itself. Therefore if the political will is found to be wanting in Romania, there is little that a foreign donor can do about it.

Legal Education - Romania follows the continental Europe model of legal education. Law is a four-year undergraduate course of study, followed by a two-year apprenticeship. At the end of their studies law graduates may choose from among several careers in the legal profession, including a judge, a public prosecutor, a government lawyer, an advocate, or a notary. For each specialty there is an examination which law graduates must pass before being accepted as a professional in that field. There is a second "examination of capacity" after the two-year apprenticeship.

The basic principles of contract law (as found in the Civil Code) have always been taught in Romanian law schools, and market-oriented commercial transactions have generally been taught in the context of international trade. Apart from these traditional courses, Romanian law school curricula have undergone a wholesale revision. There are new required courses geared to the needs of a market economy and civil society. For example, courses such as Administrative Law, Commercial Law, Constitutional Law, Banking, Tax, Finance, Insurance, Property, and the Law of the European Union either were not offered before or were altered beyond recognition.

The Romanian Bar has also undergone a major revision since 1989. Until recently, private lawyers had been required to belong to the *nomenklatura* Lawyers Union. Clients paid legal fees directly to the Lawyers Union (pursuant to a preset schedule) which withheld its fees and taxes and then paid the remainder to the lawyer working on the case. Law No. 51/1995 on the organization and practice of the legal profession changed how the Bar could operate. Law No. 51 covers access to the profession, the rights and duties of lawyers, and the organization of the profession in general. The Bar now operates as a professional association similar to that found in many countries, and Bar membership is compulsory for any practicing attorney.

F. Foreign Direct Investment (FDI) Law

1. Overview

Our analysis is based on the premise that the more an FDI regime resembles internationally accepted norms, the more attractive it will be to potential investors. As in the other substantive legal areas, our FDI indicators are intended to inquire beyond the formal legal guarantees. This includes an examination of whether government agencies and the courts afford equal treatment to foreign corporations in practice. Our Team will also meet with private business executives both local and foreign to obtain their insight into the investment climate. It will be important to distinguish between those bureaucratic hurdles that restrict investment generally and those that are aimed at foreign investors. A regulation that is investor neutral on its face, if selectively enforced, may become a de facto restriction on foreign investment. We will also investigate whether there are unwritten agreements to exclude foreign corporations from certain markets, or whether the "cost of doing business" is significantly higher for those companies. Finally, we will compare the results of FDI research with the results of our analyses of trade laws and company law.

The challenge of developing meaningful comparative indicators for FDI lies in the diversity, breadth and complexity of the subject area. The indicators developed for this purpose place heavy emphasis on compliance with international obligations and norms, rather than the details of specific national legislation. This emphasis reflects the broad trend toward international harmonization of law and practice governing cross-border direct investment. It is also based on the assumption that a correlation exists—all other things being equal—between the degree that a country's FDI regime reflects international standards and its ability to compete for and retain FDI.

The emphasis placed on international obligations, rather than on a detailed analysis of national legislation is useful for several important practical reasons. First, the data required can be obtained relatively easily and cost-effectively via widely published sources. This reduces the cost of assessment significantly and makes monitoring development and updating the analysis simpler. Second, for comparative purposes, the quality of the data is relatively uniform since in many cases a single source (e.g., WTO Secretariat; MIGA, OECD) can be used. Third, focusing on consistency with international norms provides a useful means of limiting the subjectivity inherent in comparative analysis of national legislation. This approach therefore creates an opportunity to emphasize the quantitative element to the analysis by distilling development indicators into performance measures that can be stated in relatively simple yes/no propositions for comparative purposes.

The expediency of focusing on adoption of international conventions and norms as a basis for drawing cross-country comparisons has significant limitations, however. First, a gulf generally exists between formal accession to treaty obligations and compliance with those obligations. In a practical sense, therefore, it is misleading to consider treaty accession without explicit reference to treaty compliance. In developing these indicators, an effort has been made to control for this shortcoming in two ways: 1) by attempting to capture the extent to which obligations have been limited or reserved by the acceding country during negotiations (e.g., the number of conditions

placed on right to national treatment); and, 2) by focusing on regulatory barriers to entry as a basis for characterizing the climate for foreign investment.

A second difficulty arises in the selection of international norms to be included in the analysis. Poland has made full membership in the EU a central foreign policy objective. EU membership is likely to have a significant impact in terms of Poland's future FDI flows.[13] Nevertheless, including EU membership as an indicator of commercial law development is problematic from the standpoint of cross-regional comparisons given that access to membership is not universal.

Eliminating EU (and OECD) accession from the analysis, however, poses the risk that an artificially narrow and potentially distorted view of commercial law development in Poland will be presented.[14] There is no doubt that Poland's accession to both the OECD and the EU offer significant benefits in terms of credibility, consistency, predictability and durability of the reforms.[15] Because membership in these organizations is conditioned upon meeting certain legal and administrative conditions precedent (i.e., "reforms"), membership confirms, rather than necessarily determines, Poland's emergence from "transitional" to "developed" status in terms of its legal regime for FDI.

2. Diagnostic Findings

Legal Framework

At a time when investment from the government budget is minimal, the state is not able to finance any large infrastructure projects, and domestic capital is virtually nonexistent, foreign investment remains the only serious source of capital flows for the economy. Romania has failed to realize the potential for attracting large foreign investment in the years after 1998. Total foreign direct investment is estimated at about U.S. $3.8 billion, compared to $12.2 billion in Poland. Neighboring Bulgaria, which also has not met its expectations, has received more than U.S. $2 billion, yet the figure *per capita* in Romania is the lowest among the former socialist countries of Central and Eastern Europe.

The large potential of the country to attract and absorb foreign investment has yet to be realized even though a number of multinationals are present in the Romania and operate successfully. Such commitments are due mainly to the determination of the companies' managers and their internal policies of maintaining a long-term presence in a potentially large market. Procter & Gamble, Coca Cola, Dae Woo and ING Bank are the best examples of major foreign investors; but, given the size and potential of the Romanian market, their presence is only a fraction of what

[13] To date, EU countries have invested $12.2b in Poland, representing 54.1% of total FDI in Poland as of June 1998. By comparison, U.S. investments—currently the largest in terms of volume—comprise 20.8% ($4.7b) of the total FDI in Poland; and Asian investments, led by South Korea, stand at $1.5b, or 6.6.% of the total. Polish Market Review, No. 5 (21), October 1998, Polish Agency for Foreign Investment.

[14] Put differently, the level of abstraction required to developing cross-regional comparative measures for FDI that permit "apples with apples" comparisons may yield insights of limited analytical value (e.g., "apples are fruit").

[15] Institutional Investor Credibility Index.

it should be. The Government of Romania has done little to attract small and medium size enterprises, and completely failed to bring in greenfield investment that would replace the inefficient socialist enterprises and provide new employment opportunities for the qualified and well trained Romanian labor force. For the most part, government investment incentives have not worked. On the other hand, existing foreign investment laws do not seem to be a negative factor; in fact, major foreign investors reported having no serious problems with Romania's legal system.

The legal framework for foreign investment in Romania is provided by the following laws:

- Foreign Investment Law (Emergency Ordinance 92/1997, as approved by the Parliament with Law dated November 24, 1998, and published in Monitorul Oficial (MO), #483, on December 16, 1998);
- Law on Foreign Investment in Exploration and Production of Oil and Gas (MO No. 66/1992);
- Free Trade Zones Law (MO No. 84/1992);
- Law on Stimulating Foreign Investment in Industry(MO No. 71/1994);
- Commercial Register Law (MO No. 26/1990);
- Company Law (MO No. 31/1990);
- All accounting and taxation laws and regulations, applicable to resident entities and natural persons.

The investment legislation, including the latest amendments to Ordinance 92/1997, published in ***Monitorul Oficial*** on December 16, 1998, has several positive features:

- the Romanian foreign investment regime is open;
- foreign investors are granted national treatment, except for the purpose of land ownership;
- foreign investors can participate in all transactions, which are not specifically forbidden by the law, including in the privatization program;
- there are no restrictions in the percentages of foreign participation in commercial companies;
- 100 % of the after tax profits can be converted and repatriated;
- all formal legal guarantees against arbitrary and discriminatory nationalization and expropriation are in place; and,
- there are adequate legal provisions for prompt and effective compensation in case of nationalization for public needs.

Despite the evidence of a legal framework the *inadequacies* of it are part of the reason why foreign investment in Romania remains at unnecessarily low levels. Several attempts were made to implement legislation providing various incentives for foreign investors, but the legislation passed was over-complicated, difficult to administer, unclear, and finally failed to produce the desired results. The government adopted a piecemeal approach to the problem, passing laws which in the eye of the public were designed for a particular company (e.g., Law No. 71/1994 on

Stimulating Foreign Investment in Industry is known as the "Daewoo law"), or to replace some of the existing regulations only days after having been issued.[16]

Judging by the hectic activity of consecutive Romanian governments to improve the investment environment it seems that there is general policy agreement that foreign investment is necessary and indeed beneficial for the country. At the same time, there seems to be no genuine policy discussion on how to improve the situation, and most of the advice of potential foreign investors and international experts and institutions has been ignored. The lack of consultation with the private sector and investors is a chief obstacle to developing investment legislation adequate to support economic growth and increased foreign investment. This situation seems to be changing slowly, but to the government still needs to correct the mistakes of the past and to regain its lost credibility and confidence. In general, large investors are standing on the side line and waiting for the situation to improve.

Further, the latest amendments to Ordinance 92 create some uncertainty about the rights of foreign investors to own land. This right is restricted by the Constitution,[17] but the Supreme Court ruled that foreign-owned companies, registered in Romania, should be considered Romanian entities and should have the right to own land. The text of Article 6 of Ordinance 92 states that residents and non-resident commercial companies may acquire real rights over immovable property to the extent necessary for their activities, but does not clearly state that such entities can own the land. This text is open to judicial interpretation. It is certainly less clear than the abolished Article 24 of Ordinance 31/1997, which permitted foreign companies to own land for productive purposes.

In general the existing legal framework does not help small and medium size investors, and as a result very few of those are present in Romania. Big firms, able to devote large resources to business development, have been successful in establishing themselves in the market and building profitable local operations (Procter & Gamble, Coca Cola, McDonald's, Timken, several manufacturers of automotive equipment and companies involved in energy generation).

Romania recognized the importance of arbitration in the settlement of commercial disputes when it became a signatory to the New York Convention of 1958 regarding the recognition and execution of foreign arbitration awards. Romania is also a party to the European Convention on International Commercial Arbitration concluded in Geneva in 1961 and the ICSID Convention concluded in Washington in 1965.

Romania became a member of the Multilateral Investment Guarantee Agency (MIGA), part of the World Bank group, in 1992 and has a well developed system of international investment treaties

[16] The *Implementing Regulations for Emergency Ordinance 31/1997* were published on December 29, 1997. The next day Emergency Ordinance 92/1997 was published, and it replaced most of the provisions of Ordinance 31, leaving only Articles 11-15 in force. No provisions were made for the validity of the Implementing Regulations, which of course were making references to the abolished articles of Ordinance 31/1997.

[17] Art. 41.2 of the Romanian Constitution prohibits the ownership of land by foreigners.

(there are more than 70 concluded so far, including all countries which are major sources of capital inflows).

Major foreign investors are given substantial tax incentives –as shown in the table below.

Amount of the initial investment –USD Million	Profit tax reduction - %	Years of reduction
0,5	10%	2
1	15%	3
5	25%	4
20	50%	5
35	75%	7
50	100%	10

Annex to Decree 92/1997, as approved by the Parliament with Law dated November 25, 1998, and published in Monitorul Oficial on December 16, 1998

Such incentives are difficult to administer, they distort the market and create unfavorable conditions for smaller competitors in the same field of activity. There is no evidence that such incentives were ever a decisive factor in attracting investors, unless when they are tailored to the needs of particular producer. Tax incentives should always be considered within the framework of the international obligations of Romania under treaties for avoidance of double taxation. Finally, in the long term they may prove a disincentive for the local investors.

Implementing Institutions

Two things seem most striking in Romania in the last several years—hectic and uncoordinated development, and the desire to achieve miracles overnight. The first is manifested by the number of laws passed—four in 8 years, (see the attached table of the principal laws and regulations applicable to foreign investment). This is more than any other restructuring economy (by comparison, the Czech Republic never had specific foreign investment legislation or incentives, Poland and Hungary abolished the relevant laws after several years of application and granted foreign investors unconditional national treatment). The second is reflected in the number of "emergency" ordinances, which by definition should be issued in extraordinary situations with the expectation of immediate consequences.

As in other legislative areas, part of the problem seems to be that by virtue of the conditions prevailing in a centralized economy—many Romanian decision-makers and officials in the implementing institutions are not familiar with the way in which private enterprises operate. They have never had the opportunity to work in the private sector, and consequently have little or no understanding of the problems faced by a private business. Any successful assistance program or lobbying effort should start with the review of such problems, a step, which in most cases, is overlooked. Instead, an avalanche of suggestions is being presented, and often ignored, because the officials in charge lack the time or the necessary qualifications to understand the suggestions. This does not mean that they are not capable of understanding, but rather that nobody took the

effort to explain. Instead of having a dialogue, one of the sides turns defensive and does not produce the expected results, even if a genuine willingness to change is in place. [18]

The Romanian Development Agency (RDA) is currently the main body in charge of investment coordination and promotion. Originally the RDA was established as screening institution in charge of registration and approval of every foreign investment. It was independent or part of various ministries (Privatization, Industry) at particular points in time, but after several years of existence the RDA has become an unnecessary obstacle to foreign investors. It was particularly unsuitable for an emerging capital market.

To improve the picture and ostensibly the environment for foreign investors, the government decided to restructure the former licensing authority and reestablish it as a promotion and assistance institution. The management of the new RDA seems to understand the need for change, and is looking for a new identity. RDA could use assistance in several areas: identification of suitable investment projects, promotion of investment opportunities, cooperation between the private sector and the government in improvement of the existing infrastructure, initiation of policy dialogue between the government and the investors, developing of services which can be offered to potential foreign investors. The RDA can certainly benefit from the knowledge and experience of similar local investment promotion institutions in the United States. The activities of the RDA are impeded by the lack of funds to establish a viable presence in major investment centers (London, Frankfurt, Paris and New York) and on the Internet, and by the lack of experienced and motivated staff able to undertake this task. It is only now that the management of the RDA realizes the need to compete for investors with a large group of countries at similar stages of development as Romania, and actively to promote the country and its resources, instead of waiting for interested investors to come see for themselves. However, currently the role of the RDA still is not very clearly identified.

Supporting Institutions

Romanian foreign investors are organized in the Foreign Investors Council that meets regularly and is active in identifying the problems of the investment community and in looking for solutions. In May 1997 the Council issued proposals for improvement of the investment climate in Romania. So far the government has done little to take their findings into consideration.

Foreign investors operate in Romania in a very unstable macroeconomic environment that calls for adjustment of many accounting, taxation and profit repatriation rules. In particular, the following are the most important proposals made by the Council:

[18] For instance, only one of the Proposals for improvement of the Foreign Investment Climate in Romania, presented in May 1997 by the Foreign Investors Council, were taken into account. None of the reasonable suggestions published by the monthly magazine of Herzfeld & Rubin in a Letter to the Prime Minister in December 1997 were ever discussed with the authors.

• Clarification of the accounting rules, including the inventory valuation and the treatment of foreign exchange gains and loses. (12 substantive differences were identified between the Romanian Accounting Standards and the Internationally Accepted Accounting standards in 1998).	• Improvement of the definition of taxable base. The problem in Romania seems to be that seemingly low tax rates are applied on a taxable base, which prevents business entities from claiming a number of deductions, and effectively increases the tax burden.
• Introduction of loss carried forward fiscal clause (such were introduced in 1998).	• Reducing the risk factor resulting from the unexpected introduction of conflicting legislation, which was not taken into account by the business entities at the time their annual or long - term plans for Romania were prepared.

The Council produced a detailed report, including the suggested changes. The report is a valuable and highly technical, well-prepared document, but it fails to take into account that its chief audience consists of people who have never run a private business. It does not explain to the government why the changes are necessary and fails to make one important point, which is valid for all branches of the Romanian economic legislation—that there is little or no policy discussion prior to the adoption of particular laws, and there is no study of the impact of particular legislation on the business entities, affected by it. Those two elements are essential for the success of any law.

G. Trade Law

1. Overview

The sweeping political changes that began in 1989 were to have a profound impact on virtually every aspect of commercial life throughout the CEE and NIS regions. In particular, 1991 was a year of profound change throughout the region. By early 1991, market prices, hard currency payments, and international commercial practices began to replace Soviet-era mechanisms of trade throughout most of the region. In July, the Council for Mutual Economic Assistance (CMEA) was formally dissolved. In late August, Ukraine declared itself a sovereign state. Three months later, Romania adopted a new constitution. Finally, Kazakhstan declared itself an independent nation in early December 1991.

The sweeping impacts were particularly marked in the foreign trade sector, which was both highly centralized and tightly controlled by specialized state trading organizations. With the collapse of the Soviet Union, individual firms found themselves cut off at both ends - input supply on one hand, and marketing outlets on another. Further, due to the segmentation and specialization common under the state trading system, firms were faced with a debilitating lack of information or experience upon which to draw in establishing their own foreign trade relations. Added to this, many state trading monopolies seized the opportunity spontaneously privatize under *perestroika*, and utilize special hard currency and commodity trading licenses to perpetuate their monopolistic position in the sector.

It is widely stated that a country's openness to foreign trade and investment is a major determinant in its overall rate of economic growth and the stability and vitality of its markets. Empirical evidence tends to support this view,[19] however, the recent Asia Crisis has caused some to challenge this orthodoxy.[20] Despite this, a central organizing assumption upon which this analysis proceeds is that a legal regime consistent with international norms and practices is a fundamental requirement for a modern, market oriented economy.

Trade law and the institutional framework for its implementation is an extremely broad and complex subject. As a result, it has been necessary to define the parameters of this analysis somewhat narrowly. One principal theme, however, will be the extent to which the country has embarked upon the process of accession to the World Trade Organization (WTO). The progress which a country has made in negotiating and enacting implementing legislation to accede to WTO agreements is a good preliminary indicator of the overall development of a country's international trade law. Among the many areas addressed by these agreements are market access, subsidies, health standards, trade in services, intellectual property, and government procurement. We will

[19] See, e.g., *Trade Liberalization in IMF-Supported Programs*, Sharer, R. et al., International Monetary Fund World Economic & Financial Surveys, Washington 1998; *Open Markets Matter - The Benefits of Trade & Investment Liberalization*, OECD, Paris, France 1998.

[20] *Saving Asia*, Krugman, P., Fortune Magazine. 9/7/98, www.pathfinder.com/fortune/investor/.

also focus extensively on each country's customs laws and procedures, especially the tariff levels, classification system, and whether Most Favored Nation (MFN) status is afforded to its trading partners.

It is important to note the impact of many ancillary laws on the overall trade environment. Among those which could represent substantial non-tariff barriers are tax laws, currency convertibility restrictions, and immigration and banking laws. Obviously, a detailed investigation of each of these areas is well beyond the scope of this project. It should, however, be possible to include specific examples of discriminatory treatment in an overall analysis of the country's receptivity to foreign trade.

From an institutional perspective, we will focus on the major trade regulatory bodies from the Ministry level to the customs point of entry examining staffing, budgets, information management resources, and liaison with other agencies. We will assess the degree of detail, consistency and transparency in agency procedures and compare statistics regarding enforcement. We will also attempt to gauge the degree of political support for open trade policies as expressed in public statements by government spokesmen, opposition leaders, legal academics and the popular media. Finally, we will attempt to assess the degree of satisfaction Among those most affected by the trade laws including, e.g., shipping firms and foreign chambers of commerce.

2. Diagnostic Findings

Legal Framework

Since 1989, Romania has paid particular attention to bringing its trade policy into line with the principles, rules, and regulations of the international trading system. One of Romania's main objectives is its full integration into European regional and sub-regional arrangements. It already is a member of the World Trade Organization (WTO), and had been a member of the General Agreement on Tariffs and Trade (GATT).

The state's monopoly on foreign trade as well as the central planning system—both the major non-tariff obstacles during the previous region—has been eliminated. Import and export regulations were permanently liberalized by Government Decision No. 215/1992 on import and export licenses, which stipulates that the export and import of commodities to and from Romania have been liberalized, no export or import licenses being required. In addition, a new Customs Tariff was enacted as Romania's major instrument of trade policy.

World Trade Organization (WTO) Accession - Romania did not have to go through a tortuous WTO Accession process as many transition economies are today. It had been a contracting party to the General Agreement on Tariffs and Trade (GATT) since 1971. The GATT and most Tokyo Round Agreements were an integral part of Romania's domestic legislation, and Romania fully participated in the multilateral negotiations carried out under the Uruguay Round.

By Law No. 133/1994 the Romanian Parliament ratified the Marrakech Protocol establishing the WTO, and Romania thus became an original member of the WTO. Romania is a party to all multilateral agreements within WTO, and is a party to the following plurilateral agreements:

- Agreement on Trade in Civil Aircraft;
- International Dairy Agreement; and,
- International Bovine Agreement.

As noted, the Imports Customs Tariff is the main trade policy instrument used in Romania. The present Import Customs Tariff, as well as the trade policy mechanisms and instruments, are based on the Uruguay Round results.

Romania's customs duty system already complies with European Union standards (Brussels Harmonized System). In addition, as of July 1, 1995, customs duties are applied according to the rates stipulated in the WTO Marrakech Protocol, ratified by Law No. 133/1994.

H. The "Market" for Commercial Law Reform

Creating a Virtuous Cycle of Reform - Liberalization of the business environment can be a powerful catalyst, setting off a virtuous cycle where each reform makes the next one easier. Businesses organize themselves to advocate and lobby for changes in the status quo and for new commercial laws and regulations. As the pace of reform quickens, new interest groups form and the policy agenda becomes more extensive.

The challenge is how to put this virtuous cycle into motion. At the outset of the reform process, those who prosper under the pre-existing dysfunctional system will have much to lose, while the reform-minded private sector are unlikely to have reached the critical mass needed to lobby for their own interests.

This intersection of demand for commercial law reform from the private sector, together with the supply of policy responses from the government, may be appropriately viewed as the "market" for commercial law reform. This "market" will vary from country to country, and indeed from sector to sector, depending on many factors ranging from history and culture to even how key reformers interact with government officials on a personal level.

The Current Romanian Context - At first blush, it may appear that a vigorous market for commercial law reform exists in Romania. Over the past eight years changes in legislation have affected practically every area of law. Rights of private property and the predominance of the rule of law over discretionary administrative action are recognized. Romania has established a fairly comprehensive commercial law system which has received high marks from the EBRD in its annual legal survey. Many public interest groups with strong pro-market leanings are now in existence.

Yet, as is clear from other sections of this Report, this impression would be misleading. The market for commercial law reform in Romania is imperfectly developed. The *supply* of commercial laws has often exceeded the *demand* for them. A frequent criticism of private sector companies and associations is that laws are changed too frequently. Poorly- conceived laws and regulations appear with no advance warning. This theme was echoed by Romanian business leaders, NGOs, lawyers, judges, government officials and ordinary citizens.

Practically everyone agreed that it would be better for the government to concentrate on a fewer number of essential laws which are well prepared than to enact hastily prepared drafts that only have to be corrected in the next legislative session. This would also allow the authorities more time to get the necessary implementing regulations into place. Currently an overly ambitious legislative program, combined with hastily drafted and adopted Emergency Orders, leaves very little time to make the necessary implementation arrangements and to prepare the institutions involved in the implementation of the law for their new tasks, or to establish new institutions.

The heart of the problem is inadequate consultation with concerned groups and the public by the government prior to enactment of these laws. Bills do not circulate to the public in advance of passage and in the case of implementing regulations, there is no such thing as a notice and comment period. Professional associations that might be able to offer suggestions that would improve a piece of legislation are not consulted.

The reasons for lack of consultation are several. First, most government experts and members of the Parliament never had the opportunity to work for a private business, and consequently, know little about the problems of private entrepreneurs. It may be hard for them to understand private sector concerns. Second, government officials also are probably suspicious about the motivations of the people making the suggestions. After all, not everything which is good for the private sector is good for Romania.

To have a vigorous, successful dialogue between the public and private sectors does not mean that one side wins and the other side loses. But in the "market" for commercial law reform, there must be an exchange – or a "buying" and "selling" of ideas. At the moment there is little give and take between the public and private sectors on commercial laws.

This is unfortunate. This exchange can be a "win/win" game. The private sector and pressure groups can present reasonable points which if considered (though not necessarily adopted wholesale) will result in a much better piece of legislation. It is a shame to avoid that input which can be constructive. On the other hand, the private sector's arguments may be highly technical and possibly incomprehensible to government officials with limited experience in the particular subject matter. The officials may simply decide to avoid that embarrassment by avoiding the contact.

Toward A More Rational Market for Commercial Law Reform In Romania

To arrive at a more constructive relationship between government and the private sector, each side must show more understanding of the other's position and an awareness of the constraints that each side operates under.

Is it possible that Romania is on the edge of a virtuous cycle of reform? This may well be true. The situation in Romania is far from static. There has been so much criticism directed to recent governments because of hastily-adopted legislation that there is some indication that the authorities are becoming more sensitive to this problem. Several associations mentioned that they had been recently consulted by the government relating to pending legislation.

Also there has been an explosion of non-governmental organizations in Romania in recent years. Many new interest groups with strong pro-market leanings are being created. An interaction with government officials and Parliamentary commissions is starting to take place. This may create a genuine public/private partnership that will give a new burst of energy to the reform process.

Fueling this demand for market-friendly models of legislation is a strong commitment to international integration. Romania's push to join the European Union has motivated it to adopt laws that meet EU requirements in such areas as taxation, trade and competition policy. Its membership in the World Trade Organization has also stimulated the government to make the supply of laws more responsive to the demands of international free trade.

Romania today presents the classic glass "half full/half empty" syndrome. Although the negative is quite often emphasized about Romania, the ingredients are also there for a new strong burst of reform that would take it into the top ranks of reforming countries.

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